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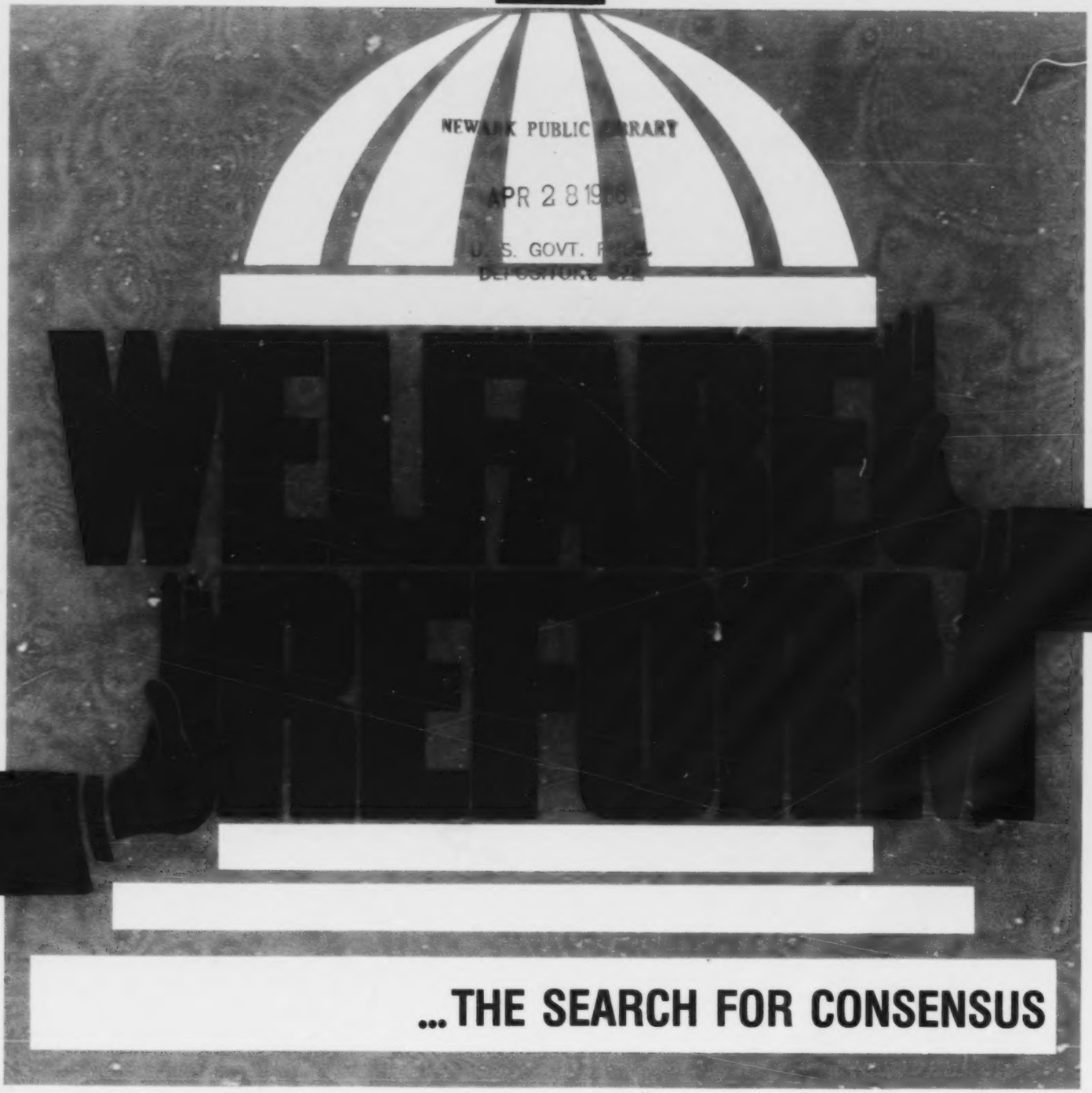

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# In This Issue . . .

**The topic of welfare reform has once again been propelled to the forefront of public debate. In this issue of *Intergovernmental Perspective*, "Welfare Reform: The Search for Consensus", we present articles based upon the statements of three witnesses, and highlights from the comments of eight others, who testified at an ACIR public hearing on February 5 in Washington, D.C. This hearing, and others to be held throughout the year, are one component of a major welfare study initiated by the Commission early last year. . . . The discussion surrounding the deductibility of state and local taxes from the federal income tax continues in our "point-counterpoint" feature. . . . A description of the Canadian experience with the Representative Tax System (RTS) provides another look at alternative measures of tax capacity and tax effort. . . . Our "Fiscal Note" presents ACIR's preliminary estimates of changes in 1986 federal income tax liabilities, by income class, under the President's and the House-approved tax reform proposals. . . . The "Intergovernmental Focus" feature spotlights the Tennessee ACIR. . . . And the "ACIR News" and the "And Briefly: Books" sections bring you up-to-date on recent Commission activities and publications.**

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# ACIR News

## President Announces ACIR Appointment

Daniel J. Elazar, Director of the Center for the Study of Federalism at Temple University in Philadelphia, has been appointed by President Reagan to be a member of the Advisory Commission on Intergovernmental Relations. He will serve a two-year term.

Elazar is an internationally recognized scholar on federalism. He edits *Publius: The Journal of Federalism*, is President of the Association of Centers for Federal Studies, President of the Jerusalem Center for Public Affairs, and has written and edited numerous publications. He is a former Guggenheim Scholar, Fulbright Senior Scholar, and the recipient of grants from the Ford Foundation, the National Endowment for the Humanities, and the National Science Foundation.

## Farm Economy Study Underway

At the request of Sentor David Durenberger (MN), the ACIR staff is preparing a report on the agricultural recession's impact on state and local government for the Senate Subcommittee on Intergovernmental Relations. A progress report will be presented to the Commission at its April 18 meeting.

The staff report will identify the intergovernmental issues that the newly-constituted National Advisory Commission on Rural America should address as part of its overall evaluation of the rural economy. Particular attention will be devoted to both the current trends in state-local aid flows and to indicators of fiscal stress.

## Welfare Reform Hearing Slated For April 18

The second in a series of ACIR public hearings on welfare reform will be held on Friday, April 18 in Washington, D.C. The hearing series is one component of a major welfare study that was adopted as part of a comprehensive research agenda by the Commission in March of last year.

Among the topics to be considered during the course of the study are: the merits and demerits of national minimum benefit standards; the advantages and disadvantages of workfare; the effects of welfare on families; and the varying capacities of the states to deliver welfare programs and services. A broad range of witnesses will participate in the hearings, including federal, state and local officials; political scientists, economists and sociologists; and other experts in the general field of welfare.

## ACIR Research Focuses on Judicial Federalism

ACIR staff have begun a study of the merits and limitations of federal court involvement in state affairs. Many observers assert that the states' position in the federal system has been altered substantially during the past 50 years through federal court decisions.

The first phase of the project has been completed, and a report entitled *A Framework for Studying the Controversy Concerning the Federal Courts and Federalism* has been published. This report outlines the scope, direction and issues which require consideration in studying the role of federal court actions.

Future research will focus on policy areas where judicial involvement has attempted to reform state and local institutions, and data will be collected on the consequences of judicial decisions on the quality of public policy and the values of federalism. Additional studies will deal with key issues of constitutional design, the legal basis of federalism, and the role of contemporary legal doctrines in federal court decisionmaking.

## Commission Meeting Set For April 18

The Spring meeting of the Advisory Commission on Intergovernmental Relations will be held on Friday, April 18 in Washington, D.C. Highlights of the business agenda include:

- a progress report on the study of the fiscal effects of federal income tax reform on state and local governments;
- a status report on a study of the farm recession's impact on intergovernmental finance;
- preliminary findings from a research project analyzing the role of fiscal discipline mechanisms in the federal system; and
- a discussion of future directions for the national/state ACIR partnership.

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Although many publications (including *Significant Features*) contain a vast array of state-by-state comparisons, they do not allow users the flexibility to compute and display the data in other forms. The spreadsheets on the diskettes developed by ACIR provide access to the Census data in a format not previously available, facilitate manipulation, and reduce the computational burden.

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The diskettes will be of considerable use to legislative and executive staff, public finance analysts, and others who wish to make interstate comparisons of government revenues or expenditures, or who need ready access to the Census governmental finance data. State-by-state data for 70 expenditure and 66 revenue classifications, and population and personal income are available for:

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# Spotlight on the Tennessee ACIR

**Harry A. Green**
**Executive Director**
**Tennessee ACIR**

A recent first-ever event highlighted the Tennessee connection with the U.S. Advisory Commission on Intergovernmental Relations. Representative John Bragg, a prominent Tennessee legislator and immediate past president of the National Conference of State Legislatures, was appointed to the ACIR. The uniqueness of this appointment is that Representative Bragg is the only person to serve actively on a state and the national ACIR simultaneously. He has served for eight years on the TACIR, was its first chairman, and currently serves as vice chairman.

However, this only highlights the Tennessee connection. Over the years, several Tennesseans have served on the national ACIR, one of whom served two appointments separated by ten years. Moreover, Tennessee appointees to the ACIR have represented most of the membership categories: two governors; one mayor; one county executive (served two separate terms); one U.S. Senator; one private citizen; and one state legislator.

Currently, another Tennessean serves on the ACIR: U.S. Senator James Sasser has been a member for seven years. Moreover, Tennessee's incumbent chief executive, Governor Lamar Alexander, served as vice chairman of ACIR until 1984, when his duties as chairman-elect of the National Governors' Association required him to resign.

The Tennessean who served two separate terms on ACIR is Judge William O. Beach—the current chairman of TACIR. Judge Beach is the former County Executive and Criminal Court Judge of Montgomery County, and served his first term on ACIR during the period of 1966-68 and his second during 1978-80. Judge Beach is also unique in that he has served in two different capacities with our state ACIR. First, Judge Beach became a member of TACIR by virtue of his position as president of the Tennessee Development District Association. When Judge Beach retired as a county official, Governor Alexander appointed him as a private citizen member. Judge Beach was elected chairman of TACIR in 1981, and has been re-elected to that position since that time. Judge Beach also has served as president of the National Association of Counties and president of the National Association of Regional Councils.

Other prominent Tennesseans who have served on the national ACIR are the late Governor Buford Ellington, the late Mayor Beverly Briley (Metro Nashville); and Alexander Heard, former Chancellor of Vanderbilt University.

### TACIR: The Beginning

In 1977, the General Assembly abolished the Advisory Commission on Intergovernmental Cooperation and created in its place, the Tennessee Advisory Commission on Intergovernmental Relations. The Commission on Intergovernmental Cooperation had been languishing for a number of years, and this legislative action represented a significant change in emphasis.

As it was established, TACIR is a permanent, independent and bipartisan commission. The members include local officials, state executive officials, members of the General Assembly, and private citizens. Originally, the Commission had 21 members, but the number was increased first to 25 members and later to its current level of 29 members.

Among the major duties of TACIR, the following are most important:

- to serve as a forum for the discussion and resolution of intergovernmental problems;
- to study and evaluate the current pattern of governmental structure and its viability for the future;
- to study and evaluate the existing and desirable allocations of state and local fiscal resources; and
- to report all findings and recommendations for change and improvement to the Governor, General Assembly, the general public, and all interested citizens.

Under this broad umbrella of function and responsibility, there are few areas of public policy that are inappropriate for TACIR attention.

### Priorities and Accomplishments

TACIR was given life during the fiscal year 1977-78. However, it was not until four years later that it was given funding to hire its own staff. During the period 1978-81, it became clear that the role and mission of TACIR was too important to depend on "loaned executives" and the budgetary goodwill of other agencies.

Three important things happened in 1981 to launch TACIR effectively on its mission. First, in recognition of anticipated changes in federal policy and funding, the General Assembly approved an appropriation to fund TACIR. This was extraordinary because the proposal was not originally part of the executive budget. Secondly, the

TACIR statute was amended to expand the membership to make it more representative. Thirdly, the General Assembly passed a resolution directing TACIR to conduct a study of President Reagan's proposed "New Federalism" and its potential impact on state–local functions and funding.

Early on in its deliberations, the Commission adopted a futuristic orientation in the pursuit of its goals and responsibilities. However, this futuristic orientation was conditioned by a constructive pragmatism relating to specific issues. Recognizing that changes in federal funding inevitably would increase the stress on local funding—and the property tax in particular—the Commission decided to conduct a comprehensive study of the property tax in Tennessee. During the next two years, the Commission conducted public hearings, reviewed staff studies, and deliberated about property tax reform. Eventually, a number of recommendations were made and several have been implemented. Among the changes proposed were property tax equalization among taxing districts, improvement in the conduct of appraisal ratio studies, computerization of assessment procedures, more frequent reappraisal, and the development of a current value index to maintain property value at full market value.

Other issues on the TACIR agenda are funding for indigent health care; a review of equity and adequacy in street, road, highway and mass transit finance; the distribution formulas for state-shared taxes; equity in school finances; and the structure and function of local governments in Tennessee.

Soon after its initial funding, Governor Alexander addressed the TACIR membership, and outlined his views about the proper role of the Commission, and emphasized three major responsibilities:

- collect and analyze data;
- prepare and distribute reports based on that data and analysis; and
- play a leading role in the reformation of state–local relations, finance and state–local governmental structure.

The Commission has actively pursued these responsibilities and finds that its role is growing. This growth is due to the changes in federal–state relations, and because of the increasing recognition that TACIR is an appropriate body to study and deliberate on changing state–local relations.

TACIR has published 45 different reports and bulletins, and has prepared numerous unpublished reports on limited selective policy issues. As an indication of its concern about local fiscal relations and tax equity, the Commission has published 11 different reports and bulletins on the property tax.

In addition, the Commission has held 24 official meetings plus a number of special committee meetings. Currently, TACIR is working on the following ten policy areas, on which it plans to make recommendations for change:

- A consistent uniform policy for tax equivalent payments by municipal utility systems
- A current-value index proposal that could save millions of dollars in property reappraisal costs and improve tax equity

**Current Members, TACIR**

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**Colonel James Norwood, Cookeville**
**Mr. Thomas E. Settles, Nashville**

- An equitable, responsible and reasonable approach to the financing of indigent health care
- An evaluation of "possessory interest taxation" and its potential impact in Tennessee
- An evaluation of disparities in per pupil expenditures among the state's school systems
- An evaluation of an appropriate methodology for the measurement of local fiscal ability and fiscal effort
- An evaluation of equity and efficiency factors in state–local shared taxes
- An evaluation of equity criteria for the distribution of shared motor fuel taxes
- An evaluation of the powers, functions, patterns and responsibilities of local governments in Tennessee
- An evaluation of the impact of changes in federal policy and funding on state and local government in Tennessee.

### The TACIR Concept

The membership of TACIR is one of its most significant features. Many important policy makers serve on the Commission, and this improves its role as a forum for the discussion of intergovernmental policy. For example, the respective chairmen of the House and Senate Finance, Ways, and Means Committees are *ex-officio* members. In addition, two other legislators—one from the House and one from the Senate—are long-term members of the respective finance committees. Moreover, the other important financial officers of the state—the Commissioner of the Department of Finance and Administration and the Comptroller of the Treasury are *ex-officio* members.* In addition, the leadership of each major sector of local government is represented on the Commission, as well as important private citizens. This serves to support and underscore what is probably the most important function of the Commission: to serve as a forum for the discussion and resolution of intergovernmental problems and issues.

*All TACIR *ex-officio* members have full voting rights.

Representative Bragg, a strong supporter of the ACIR concept, recently observed that "the most important thing that any state can do at this juncture of the evolution of American federalism is to create an ACIR. It is the only type of institution that provides an objective forum for the resolution of critical state–local issues that will shape our future. I urge every state without an ACIR to create one, and for those states that already have them, I recommend that they be strengthened."

In the words of TACIR Chairman Beach, "the importance of the Advisory Commission is so great to our future capacity to govern, that if it did not exist, we would have to invent it."


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# Federalism and Welfare Reform

Daniel J. Evans

**I would like to commend ACIR for its focus on welfare reform. I believe it is a timely discussion because an effective welfare system can only emanate from an effective federal–state partnership. Next year—1987—will mark the beginning of the bicentennial of our Nation's Constitution. It is the hallmark of our free society, providing guarantees of fundamental rights and a blueprint for sound government organization. As we prepare to celebrate the Constitution's 200th anniversary, it is appropriate that we reassess the effectiveness of our intergovernmental relationship. Therefore, a renewal of the federalism debate is essential to the continued well-being of our system of government.**

## New Federalism Report and Recommendations

In 1984, the Committee on Federalism and National Purpose was convened under the auspices of the National Conference on Social Welfare's Project on the Federal Social Role. The committee, which I had the privilege of co-chairing with Governor Robb of Virginia, was comprised of representatives from all levels of government, having broad and diverse viewpoints. Recently, the Committee issued a report on federalism which represents a bipartisan and well-reasoned plan to renovate our system of government.

At the root of all the ills plaguing our system of federalism is the irrational and illogical nature of intergovernmental relationships. In addition to this nonsensical organization, there is a fundamental lack of trust among various levels of government. Both symptoms have led to excessive regulations, duplication of efforts, and a convoluted division of responsibilities. Instead of recognizing the new and advanced capabilities of state and local governments to administer programs requiring individual services, the federal government has maintained a heavy and burdensome presence.

The appropriate role for the federal government is to maintain a commitment to fundamental needs requiring national uniformity. At the same time, it should relinquish control of responsibilities best executed by the states. In pursuit of this goal, the Committee made various recommendations to improve the effectiveness of federal welfare programs. I would like to review them briefly.

The consequences of an illogical intergovernmental structure are readily apparent in our present welfare system. The growing economic vulnerability of the poor is aided in large part by the unfairness of our income support programs. The current inequities in AFDC are disgraceful. In January 1985, the maximum AFDC grant for a family of three was $555 in California and $118 in Alabama. To be poor and hungry in New York, however, is not much different than being poor and hungry in Mississippi, Maine or Missouri. In some states, eligibility ends when family income exceeds 49% of poverty level income. Yet, in other states, it extends to families with incomes equal to or above the poverty threshold. In 25 states, families containing both parents are not eligible for AFDC, or for that matter, any federal cash welfare benefits, no matter how destitute they may be.

To eliminate these benefit inequities, the Committee recommended that the federal government establish national minimum benefit levels and eligibility standards for the AFDC and medicaid programs. A national benefit floor should be established and maintained for AFDC and food stamps which is between 75% and 90% of poverty-level income.

The Committee also recommended that the federal government assume full policy responsibility for AFDC and medicaid as well as 90% of the financial responsibility of the minimum benefit levels. States should maintain administrative responsibility for these programs. In addition, more emphasis should be placed on state administration of employment programs supporting AFDC by expanding education,

training and placement activities. The welfare system, to the maximum extent possible, should be a jobs system.

The anticipated rapid growth of the Nation's elderly population will bring with it new demands for the provision of long-term care. Although medicaid provides these services, they are offered in the same way as acute medical care. Our failure to recognize the difference has created an over-reliance on nursing homes and hospitals, instead of encouraging use of less costly and more humane alternatives such as home care and community support services. Therefore, to promote more cost-effective and efficient service delivery, the non-medical component of long-term care should be separated from the rest of the medicaid program. This segment should be converted into a federal block grant to states, indexed for changes in the program's cost and the population it serves.

While the federal government assumes greater policy and financial responsibility for AFDC and medicaid, it should devolve other areas to state and local governments which is an essential element in this new partnership. I am reminded of Alexis de Tocqueville's observation of the dire consequences of "combining centralized government with that of centralized administration; uniting the habit of executing its commands to the right of commanding; and establishing the general principle of government and descending to the details of their application . . . freedom would soon be banished from the New World."

Specifically, states and localities should assume full financial, policy and administrative responsibility for many community development, local infrastructure, and social service programs. Thus, the more than 200 remaining intergovernmental programs funded by the federal government at less than $100 million either should be consolidated into block grants or absorbed into existing programs. The remaining shared programs should be directed more toward localities with the most needy. To accomplish better targeting of resources, more reliance should be placed on states. A relationship with greater dependence on states will foster more trust. Thus, we should use incentives rather than sanctions to hold states and localities accountable for program administration.

In order for states to meet their present and future service obligations, the federal government should provide general support grants targeted to states with low fiscal capacity. Until the effects of devolution can be assessed adequately, a transitional federal assistance program should be established and administered by states for localities with the least fiscal capacity.

### Implementation

It is important to emphasize that these recommendations are intended to be a comprehensive package, implemented together. Also, it should be acknowledged at the outset that proper and effective reform will take several years. With the critical demands of deficit reduction, accomplishment of these objectives must be, at a minimum, revenue neutral.

I do not believe that the need to eliminate unacceptable federal deficits in the Gramm-Rudman environment hinders new federalism reform. Rather, I believe it has provided us with a window of opportunity. Gramm-Rudman will require reassessment of our basic commitments to find more cost-effective means for targeting and delivery of less federal resources. Implicit in Gramm-Rudman, however, is a framework for new federalism in the continuing federal commitment to major income assistance programs. For example, among the programs exempted from sequestration are AFDC, medicaid and food stamps. Therefore, I believe federalism reform is an essential element of establishing and maintaining principled Gramm-Rudman policy, requiring ultimate goals and immediate first steps.

In an effort to maintain a focus on new federalism in the Gramm-Rudman process, I intend to introduce a concurrent resolution committing us to the deficit reduction targets in Gramm-Rudman and calling for the budget and policy decisions in reaching these targets to be consistent with the new division of intergovernmental responsibilities called for in the Committee's report. There are several other legislative steps I will take to keep this debate alive in 1986.

Recently, Senator Dave Durenberger (MN) and I introduced legislation to establish a Targeted Fiscal Assistance program. Under this proposal, general purpose grants would be available to local governments, allowing local officials and citizens to determine how best to use such funds. An interstate formula would determine each state's allocation. By utilizing appropriate measures of need and fiscal capacity, the program will target funds to those communities with the greatest needs.

Reform of federal quality control in AFDC, medicaid and food stamps is another area of critical importance to a sound and stable intergovernmental partnership. The existing system illustrates most vividly the major shortcomings in the federal-state partnership, for it is a system premised on distrust. The current practice of imposing punitive sanctions against states for errors in program administration does not help them become better program managers—which should be the real objective of quality control. Instead, it has exactly the opposite effect. Not only do large fiscal penalties place undue strains on already-sparse state resources, but they hurt the very people the programs are intended to serve. We were successful last year in initiating a major study of the food stamp program and a temporary moratorium on penalty collections; however, much more needs to be done. Therefore, I will continue to push for comprehensive reforms in federal quality control for AFDC and medicaid.

Our long-term focus is on developing major proposals for a greater federal role in AFDC and medicaid and a block grant program for long-term care under medicaid. The key element in this effort is to provide for a trade-off between federal and state governments that is both fair and revenue neutral. In some areas, it may be possible to have more than a dollar-for-dollar trade-off; for example, for every $10.00 the federal government relinquished, states may be able to pick up $12.00 or $13.00. The primary financing method for devolution would be the fiscal dividend gained from federalization of welfare programs.

## Conclusion

In conclusion, I believe a renewal of the federalism debate is essential. As we move forward, we should remember the words of de Tocqueville when he observed, "a centralized administration is fit only to enervate the nations in which it exists, by incessantly diminishing their local spirit. Although such an administration can bring together at a given moment, on a given point, all the disposable resources of a people, it injures the renewal of those resources. It may ensure a victory in the hour of strife, but it gradually relaxes the sinews of strength. It may help admirably the transient greatness of a man, but not the durable prosperity of a nation." Thus, it is critical that we take great care in our efforts to unite policy-making with implementation in reshaping the federal role.

Our founding fathers envisioned a shared system of government with a logical and productive division of responsibilities. It is time that we reexamine the federal-state partnership and make necessary improvements to ensure its continued vitality. I can think of no better bicentennial birthday present for this nation in 1989 than to reestablish the essential partnership between states and the union that gave birth to our Constitution.

*Daniel J. Evans is a U.S. Senator from the State of Washington. A former governor from that state and president of Evergreen State College, he served as a member of ACIR from 1973 to 1977.*

# Public Welfare Reform Issues

William G. Colman

**When the recommendation to nationalize AFDC and Medicaid financing was adopted by the ACIR in 1969, I personally favored it strongly. In 1971, I was also strongly in support of President Nixon's initiative along similar lines. By the mid-1970s, I had concluded that such a step was fiscally unwise, because of the wide disparity among regional living costs and the apparent unwillingness of the Congress ever to agree to incorporate regional or other cost differentials into financial transfer programs to individuals.**

In recent years it also has become apparent that if welfare dependency and its relative permanence in a substantial proportion of recipients is to be lessened, a range of state and local programs and support services must be re-directed in such a way as to enhance the transfer of individuals from welfare rolls to payrolls especially in private sector employment. The close relationship between welfare rolls and state-local programs for private sector job training, remedial education, subsidized day care, and other social services is a formidable consideration in the allocation of financial and administrative responsibility for public assistance in the United States. If all or most of the cost of AFDC was assumed by the federal government, energy and resources at state and local levels now directed toward re-orienting welfare toward *employment*—in contrast to income maintenance—might be expected to falter and decline, because the fiscal pressures for change would no longer be felt as strongly as at present.

**"Limited Swaps".** I think there are strong arguments for the kind of swaps suggested by the Committee on Federalism and National Purpose in its recent report, *To Form A More Perfect Union*. However, such swaps should approach revenue neutrality, with net reductions on the state-local side to approximate fiscal savings achieved through grant consolidation. I think the Committee's figure of a federal share of 75% to 90% of AFDC, Medicaid and food stamp programs is too high, and as indicated later, interstate differences in living costs argue against uniform minimum benefit levels across the nation.

I think the most important sentence in the welfare section of the Federalism Committee's report is: "To the maximum extent possible, welfare systems should be converted into job systems." The financial dimensions of the Administration's catastrophic health cost proposal need to be assessed in terms of extent of state fiscal relief from part of long-term nursing home care costs.

**Intergovernmental responsibility for financing and administration.** In general, (1) the present welfare system needs to be replaced with a job placement-oriented system that encompasses existing state-local general assistance, as well as AFDC recipients; (2) medicaid should operate as at present, as a needs-based medical assistance program, with economic eligibility based on standards similar to those for obtaining *transitional* income support under the reformed welfare system; (3) whatever increases are effected for federal welfare and medical assistance outlays should be offset by fiscal reductions through transfers of full financial and policy responsibility to the states for selected categorical grants; and (4) administrative responsibility for welfare should be further devolved to the states, including the decategorization of the present system, with the new program covering a portion of defined outlays for economically needy persons under 65 years of age.

**Emphasis on workfare.** As indicated earlier, the new system should be oriented to job training and job placement. Several promising initiatives are already underway, especially in California, Massachusetts, Oregon and Maryland. An ACIR draft state legislative proposal, entitled "Comprehensive Employment Training, Placement and Relocation Assistance Act", developed in 1984 as part of the Commission's report on states and distressed communities, contains a Title V: "Employment and Training of Public Assistance Recipients and Disadvantaged Youth." It contains a series of alternative program approaches to the workfare issue. It should be kept in mind that subsidized day care, at least during the training and placement period, is a

necessary component of most successful efforts to move recipients off welfare rolls into full-time employment.

**Safety net for low fiscal capacity states.** The provision of a safety net depends upon the way a block grant for welfare and associated purposes is structured, and especially on the matching or reimbursement formula and on the extent that minimum and/or maximum benefit levels for federal participation are specified in the legislation. It is also dependent on whether a welfare/Medicaid swap involves state assumption of full fiscal responsibilities in other fields now federally aided in larger or lesser proportions.

The sharp decline in petroleum prices, the resurgence of the New England and New York economies, and other economic shifts appear to lessen considerably the justification for a national fiscal capacity equalizing program. As suggested below, any national minimum welfare benefit level perhaps raises more problems than it resolves; benefit levels in a state rest on an amalgam of considerations—relative state-local fiscal and administrative responsibilities for particular functions, priorities among competing needs, and differing values and policies of tolerating or discouraging long-term welfare dependency on the part of employable persons.

**National eligibility and benefit standards.** One or more broad national standards of eligibility are both necessary and desirable (e.g. economic need—as determined by a state—and below 65 in age). Any national definition of need must be related to state income and other relevant statistics for states or individual metropolitan areas and not to national averages, and must allow state differentiation based on price levels and costs of living differences within the state. Unless a national benefit standard provided wide flexibility, it would probably turn out to be unduly costly and unacceptably inequitable.

**Has the welfare system helped or hurt the poverty populations?** On balance, and despite its many failures, federal aid for public assistance has substantially helped the needy people of America by removing the county poor house from our society and otherwise lessening the social gap between the economically unfortunate and the rest of the community. Secondarily, federal welfare aid over many years helped provide, along with SSI and Social Security, a needed floor for the economies of low income states. As interstate economic and fiscal disparities continue gradually to abate, this aspect of federal welfare aid diminishes in importance.

**Relative governmental efficiencies in welfare administration.** In defining "welfare programs," for purposes of this question as a combination of AFDC and general assistance, state and local governments obviously are in a much better position to administer a reformed structure of such a combination than is the national government, because the variety of related and supporting services—vocational education, adult literacy training, specialized occupation-specific train-

ign for private sector employment, day care, enforcement of workfare provisions, etc.—all are administered and financed largely or totally by state or local government. Unless we are to have an automatic pilot type of means-tested *entitlement* program along the lines of SSI, with no particular objective of relating the program to goals of self-sufficiency and full-time, permanent employment, then primary responsibility for administration of, and significant financial responsibility for, the program must be lodged with state governments.

A work-oriented welfare program requires a state-local, not a national, context because the federal government is not in a position to establish a welfare office of its own in every county and large city in the United States. In contrast to SSI, AFDC and general assistance recipients are either in or about to enter the educational system or are members of the potentially available labor force, not being disabled or elderly. Fortunately, many earlier restrictions upon state actions in the poverty area have been removed or substantially modified. If federal regulations continue to inhibit states from the enactment of relative responsibility or lien-recovery legislation, then such regulations should be re-evaluated.

**Improved targeting of means-tested anti-poverty programs.** Lien-recovery and relative responsibility laws where such do not already exist would conserve resources appropriated to poverty relief, as would further modification of Medicaid legislation and regulatory controls to permit more home care, although some of the more counter-productive federal requirements in this regard have already been modified.

**Splitting financial and administrative responsibilities.** As indicated earlier, financial responsibility for welfare needs to continue to be divided between federal and state governments. Primary responsibility for administration needs to be vested in the states, because all of the public support services associated with welfare as enumerated earlier have their roots in state law.

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# The New Era in Welfare Reform

Leslie Lenkowsky

**On February 4, President Reagan joined every president since John F. Kennedy in calling for an effort to change fundamentally the American welfare system. Each denounced the existing public assistance programs as a "disgrace," a "mess," a "narcotic," or worse. Each sought to achieve similar goals: to offer better help to the needy, to reduce dependency, to strengthen the family. And so far, none has succeeded.**

Whether or not President Reagan will be able to triumph where his predecessors have failed remains to be seen. He faces a number of obvious disadvantages: a far larger and more complex set of programs, a budgetary outlook that permits no additional spending, a poverty level that is near a 20-year high. Each of these makes solving the welfare problem more compelling—and more difficult.

However, President Reagan also has at least one great advantage over his predecessors. Although fundamental changes have not occurred, the past 20 years have not been fruitless for welfare policy. We have observed, we have experimented, we have learned. Perhaps not as much as we would have liked; certainly much more than when we began. Moreover, despite what often appears like a loud statistical cacophony, most of the research on poverty and dependency is remarkably consistent. Properly understood, it offers considerable aid in fashioning a new proposal for welfare reform.

Let me review briefly the key findings and then sketch what I take to be their implications for public policy, and particularly for the roles of federal, state and local governments in providing public assistance.

### Poverty

Two decades ago, a major impetus for reforming the welfare system was to reduce poverty. Despite a growing economy and new education, employment and community development programs, millions of Americans were poor. Many seemed likely to stay that way, since, being old or very young, they were effectively outside the labor force. The existing welfare programs did not seem up to the job of raising their incomes to minimal standards, since benefit levels varied widely from state-to-state and almost nowhere did they come close to the poverty line. Hence, reformers sought to increase the amount of money that was provided or even establish a national "floor" for public assistance. This was known as the "income strategy."

The proportion of the American population that is poor is not much different now than it was in the mid-1960s. However, we now have a much clearer picture of who the poor are and why they are in poverty. And contrary to our earlier impression, we know that most of the poor do not stay poor very long.

According to a number of studies, the best known of which was done at the University of Michigan, the poverty population is remarkably fluid. Over an extended period of time, such as a decade, a relatively large number of Americans—aproaching 25%—are likely to be poor at one time or another. Most of them do not suffer this hardship for more than a brief period of time, while only a tiny fraction—approximately 3% of the population—are poor persistently.

In other words, if one were to track all the people who *fell* into poverty today, one would find that a large number of them were no longer poor a year from now and fewer and fewer remained in poverty each subsequent year. Yet, if one looked only at those who *were* poor today, a sizable proportion would be found to have been in poverty for quite some time.

These findings do not imply that employing an "income strategy" is unnecessary. To the contrary, for the portion of the population that is persistently poor, it may be the most useful way of providing help. And even the temporarily poor may derive some benefit from public assistance programs. However, the more significant implication is that a hike in benefits, or a national floor, will not be essential for most of the people who become poor. Thus, these objectives may not be as important for welfare reform as they used to seem.

### Dependency

This judgment is reinforced by what we have found out about the relationship between public assistance benefits and welfare dependency.

Twenty years ago, one of the problems of the existing programs seemed to be that they offered no incentive to

work. For each dollar a recipient earned, a dollar in benefits was taken away. Not surprisingly, many experts concluded that this formula encouraged those who could work to remain on relief, rather than try to become self-supporting.

The "thirty and one-third rule" adopted in the *Social Security Amendments of 1967* was supposed to change that. It enabled recipients to retain a portion of their earnings without losing any benefits. This financial incentive was buttressed by a variety of administrative rules, training requirements, and job-creation schemes. Together with similar provisions built into other welfare programs, they were expected to cause welfare dependency to decline.

Nothing of the sort happened. The size of the caseload for Aid to Families with Dependent Children (AFDC) has not changed much since 1972—the number of families has actually gone up—and we now have a good idea why. Any incentives for self-support created by the various reforms were more than offset by the dependency-producing effects of the income available through public assistance.

This relationship has been established in several ways. Looking at differences among states, a number of researchers have concluded that higher benefits have reduced the hours worked by welfare mothers. Using longitudinal data on family incomes, other scholars have reported that women were less likely to work their way off AFDC in states that provided higher benefits. The negative income tax experiments revealed that income guarantees produced a significantly greater drop in effort among recipients than among a control group. The decline was especially pronounced among wives and female heads of families.

Although these studies often disagree about the magnitude of these effects or their significance, they all confirmed that public assistance provides an attractive alternative to low-paying employment, especially for women. Indeed, adding financial incentives was as likely to enable recipients to remain on the welfare rolls as to work their way off. Training and employment programs rarely improved matters.

Of course, the new "workfare" projects underway in about half the states might possibly show better results. The evidence is not yet in. However, the experience of the last two decades is thin on encouragement. Most of what it tells us is that welfare programs are far more adept at increasing dependency than other measures are at reducing it.

### Family Stability

More surprising, and more alarming, is what we have learned about the effects of public assistance on families. Starting with President Kennedy, this has been a concern of every effort at welfare reform. Many experts have argued that since AFDC was usually available to single-parent households, it contained an incentive for families to dissolve (or never to form), thus lowering their standard-of-living and increasing the likelihood of long-term poverty and dependency. However, there was little evidence on the point and much disagreement.

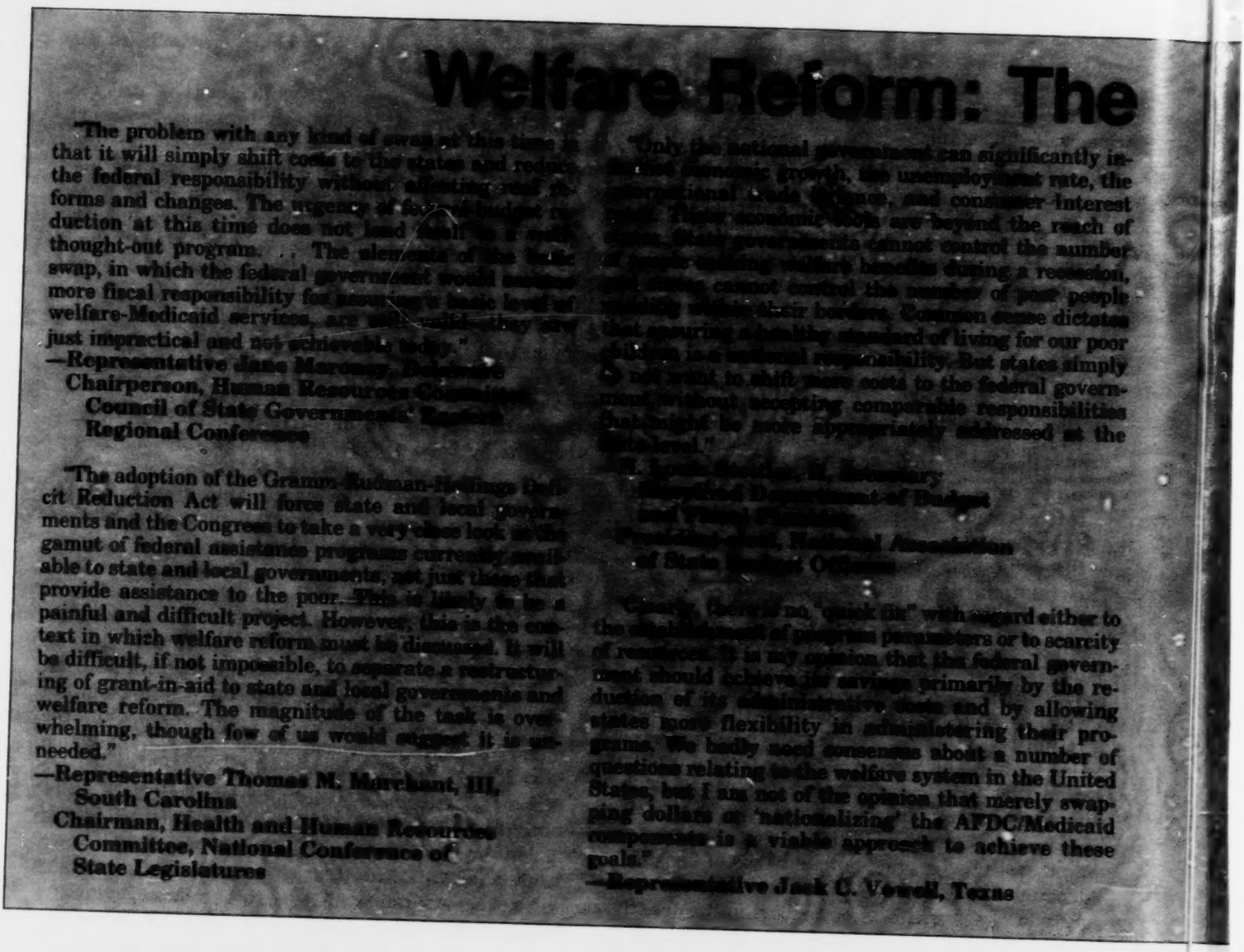
Now, we know more and while there is still considerable argument, it is mostly over interpretations rather than data. No matter what methods they used, researchers have generally found that AFDC does have a significant influence on family stability. Comparing data from states or cities that give different amounts of public assistance, several scholars have reported that higher welfare benefits raised the proportion of female-headed families. On the basis of interviews with recipients, another group of researchers found that in at least one-fifth of the cases, the availability of AFDC was instrumental in the decision to break up the family. Using longitudinal data, two Harvard experts estimated that increasing welfare benefits by $100 per month would produce a 15% upswing in female-headed households.

The most persuasive evidence comes from the negative income tax experiments. They demonstrated that income guarantees would lead families to dissolve more often than comparable families in a control group. Indeed, the differences could be large, with family break-ups sometimes as much as 50% more common among the group receiving assistance than in the one which was not. Although these findings came from tests of a proposed alternative to the existing welfare system, they are consistent with other research on the impact of AFDC in those states (about half) which provide benefits to families where both parents are present. Whatever the rules of eligibility, public assistance really seems to serve as a kind of alimony for low-income women, enabling them to head their own households and raise their children alone.

No experts seriously dispute this anymore, but many do question whether AFDC has a causal role or merely a responsive one. Such scholars maintain that welfare mostly influences family composition by enabling single parents to live independently or to postpone remarriage, rather than inducing divorce or illegitimacy. Nonetheless, even if only responsive, public assistance reinforces whatever impels a woman to set up a family on her own. And for many women, that decision is an economically tragic one, drastically reducing their chances of attaining adequate living standards for their families.

### Policy Implications

Knowledge does not always produce answers. While we have learned a great deal about welfare policy during the last 20 years, one might wonder whether we have come far in knowing what to do next. The case for a national floor seems somewhat weaker; the likelihood that an effective set of work incentives can be devised on a broad scale seems more remote. So long as we are unwilling to deny assistance to mothers and young children, the prospect of avoiding harm to the family seems problematic.


Welfare Reform: The
"The problem with any kind of swap at this time is that it will simply shift costs to the states and reduce the federal responsibility without affecting real reforms and changes. The urgency of federal budget reduction at this time does not lend itself to a well thought-out program. . . . The elements of the basic swap, in which the federal government would assume more fiscal responsibility for financing a basic level of welfare-Medicaid services, are well-intentioned, they are just impractical and not achievable today."
—Representative Jane Maroney, Delaware
Chairperson, Human Resources Committee
Council of State Governments' Eastern
Regional Conference
"The adoption of the Gramm-Rudman-Hollings Deficit Reduction Act will force state and local governments and the Congress to take a very close look at the gamut of federal assistance programs currently available to state and local governments, not just those that provide assistance to the poor. This is likely to be a painful and difficult project. However, this is the context in which welfare reform must be discussed. It will be difficult, if not impossible, to separate a restructuring of grant-in-aid to state and local governments and welfare reform. The magnitude of the task is overwhelming, though few of us would suggest it is unneeded."
—Representative Thomas M. Marchant, III,
South Carolina
Chairman, Health and Human Resources
Committee, National Conference of
State Legislatures
"Only the national government can significantly influence economic growth, the unemployment rate, the international trade balance, and consumer interest rates. These economic tools are beyond the reach of state governments. State governments cannot control the number of people needing welfare benefits during a recession, nor can they control the number of poor people migrating within their borders. Common sense dictates that ensuring a healthy standard of living for our poor children is a national responsibility. But states simply do not want to shift more costs to the federal government without accepting comparable responsibilities that might be more appropriately addressed at the state level."
Director, National Association
of State Budget Officers
"Clearly, there is no 'quick fix' with regard either to the establishment of program parameters or to scarcity of resources. It is my opinion that the federal government should achieve its savings primarily by the reduction of its administrative costs and by allowing states more flexibility in administering their programs. We badly need consensus about a number of questions relating to the welfare system in the United States, but I am not of the opinion that merely swapping dollars or 'nationalizing' the AFDC/Medicaid components is a viable approach to achieve these goals."
—Representative Jack C. Vowell, Texas

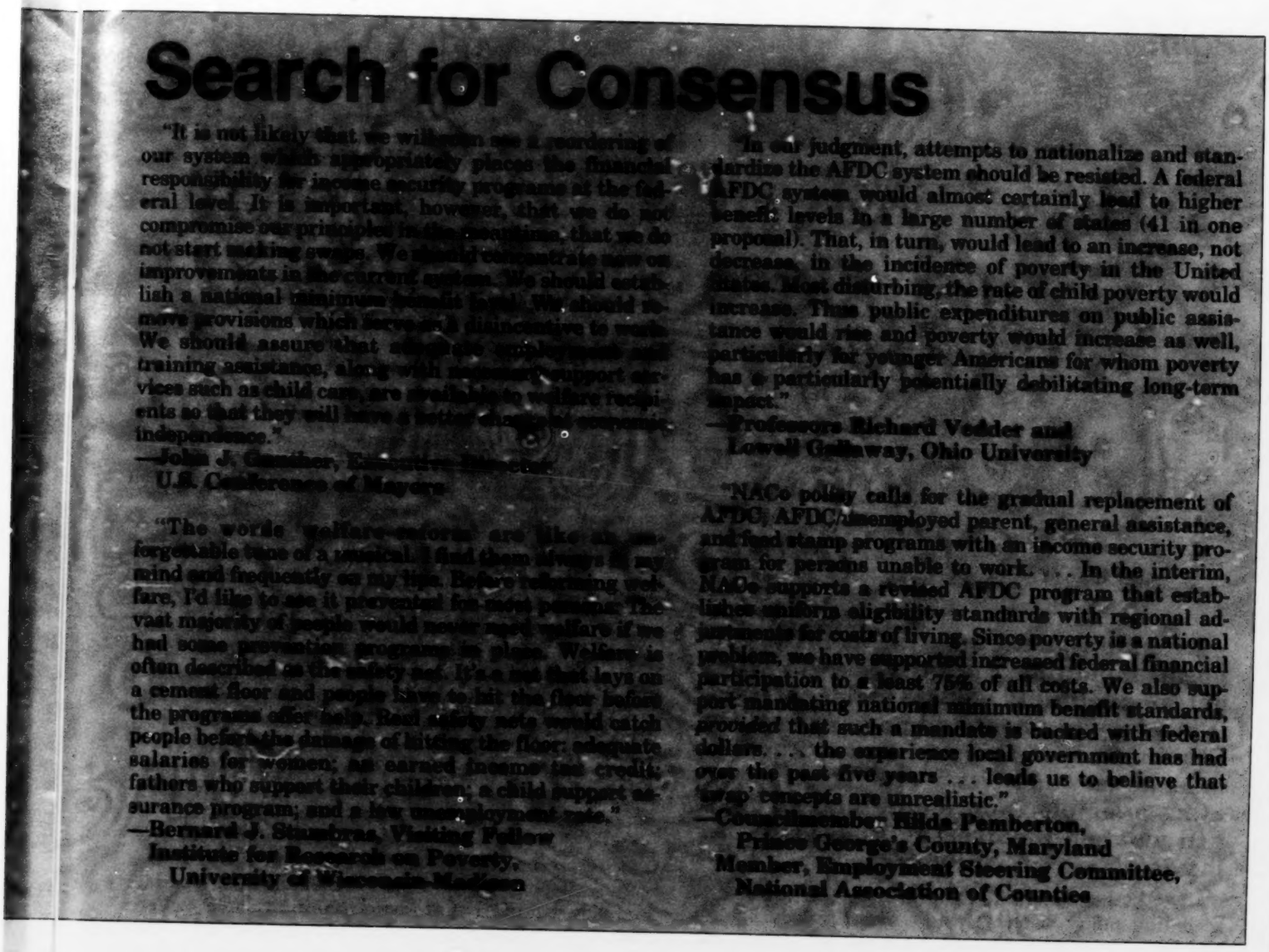
Yet, such an assessment would be unduly pessimistic. The real lesson to be learned from the last two decades is not that welfare reform is hopeless but that the illusions we once held about it need to be abandoned. In particular, the idea that we could establish a "guaranteed income" for working-age families with children, which was as generous and efficient as Social Security, while promoting independence and family stability, should be laid to rest.

That does not mean that welfare reform is dead. To the contrary, for the last few years, it has been flourishing. And right where it needs to: in state, county and city governments.

If the research on welfare prompts any generalization, it might be that the solutions to the problems identified by every president since Kennedy can only be found locally. Only those who are sensitive to the particular conditions in which a family lives can know how much assistance is needed and for how long. Only by knowing who is ready to become self-supporting, and who is not, can one make training and employment programs succeed. Only by bringing to bear legal, social and moral suasion—that is, communal values—can parental responsibility for children be enforced. In other words, what is necessary for a successful welfare reform is not a new national program, but hundreds of new local ones.

From California to Massachusetts, such efforts have been springing up more frequently than anyone would have imagined several years ago. Not all are carefully developed; some may even be misguided; most have not begun to explore the opportunities they have at hand. They need to be encouraged, assisted, evaluated and expanded. For only out of such grassroots efforts will effective ways of dealing with the problems of poverty and dependency emerge. Moreover, without such efforts, federal goals could not be achieved.

One way of doing that is to change the incentives state and local governments have to improve their welfare programs. Under the current, open-ended matching formula, they "lose" money—their own—if they increase benefits and they also "lose" money—in this


Search for Consensus
"It is not likely that we will soon see a reordering of our system which appropriately places the financial responsibility for income security programs at the federal level. It is important, however, that we do not compromise our principles in the meantime, that we do not start making swaps. We should concentrate now on improvements in the current system. We should establish a national minimum benefit level. We should remove provisions which serve as a disincentive to work. We should assure that adequate employment and training assistance, along with necessary support services such as child care, are available to welfare recipients so that they will have a better chance at economic independence."
—John J. Gunther, Executive Director
U.S. Conference of Mayors
"The words 'welfare reform' are like an unforgettable tune of a musical. I find them always in my mind and frequently on my lips. Before reforming welfare, I'd like to see it prevented for most persons. The vast majority of people would never need welfare if we had some prevention programs in place. Welfare is often described as the safety net. It's a net that lays on a cement floor and people have to hit the floor before the programs offer help. Real safety nets would catch people before the damage of hitting the floor: adequate salaries for women; an earned income tax credit; fathers who support their children; a child support assurance program; and a low unemployment rate."
—Bernard J. Stumbras, Visiting Fellow
Institute for Research on Poverty,
University of Wisconsin-Madison
"In our judgment, attempts to nationalize and standardize the AFDC system should be resisted. A federal AFDC system would almost certainly lead to higher benefit levels in a large number of states (41 in one proposal). That, in turn, would lead to an increase, not decrease, in the incidence of poverty in the United States. Most disturbing, the rate of child poverty would increase. Thus public expenditures on public assistance would rise and poverty would increase as well, particularly for younger Americans for whom poverty has a particularly potentially debilitating long-term impact."
—Professors Richard Vedder and
Lowell Gallaway, Ohio University
"NACo policy calls for the gradual replacement of AFDC, AFDC/unemployed parent, general assistance, and food stamp programs with an income security program for persons unable to work. . . . In the interim, NACo supports a revised AFDC program that establishes uniform eligibility standards with regional adjustments for costs of living. Since poverty is a national problem, we have supported increased federal financial participation to at least 75% of all costs. We also support mandating national minimum benefit standards, provided that such a mandate is backed with federal dollars. . . . the experience local government has had over the past five years . . . leads us to believe that 'swap' concepts are unrealistic."
—Councilmember Hilda Pemberton,
Prince George's County, Maryland
Member, Employment Steering Committee,
National Association of Counties

case, federal funds—if they reduce their caseloads. Not surprisingly, there is great hesitation about doing either. A new approach—perhaps through a block grant or "performance bonuses" added to the matching grant—deserves careful study.

By the same token, perhaps the best step the federal government can take to reform welfare is to maintain a period of steadiness in national policy. The current round of innovations began with the defeat of the Carter Administration's "Program for Better Jobs and Income" in 1978. After a decade of uncertainty, the prospect of dramatic federal changes had come to an end, and state and local governments began to take matters into their own hands. Were the White House to put forth a sweeping consolidation of the existing programs, or a "swap" of responsibility for them, as proposed by ACIR, the momentum that has already built up behind welfare reform may well slow down until Washington decides what to do next.

It would be far better to recognize that a new era is underway. The national route to reforming welfare has ended; the state and local one has begun. And while it may not always be smooth, it may offer a better chance to deal with the problems of poverty and dependency than we have had for a long time.

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***Point***

# Deductibility: Elimination Can Bring More Equity and Stronger Federalism

Richard S. Williamson

**President Reagan's tax reform proposal, including the provision to eliminate deductibility of state and local taxes, is good government and good federalism. Elimination of this tax deduction first must be viewed in its overall context: creating a simpler, more equitable tax system wherein the average American's tax burden is significantly reduced.**

ACIR has calculated that 79% of all taxpayers, including many of those who currently deduct state and local tax payments, will get a tax cut, or pay the same amount in federal taxes, as a result of the President's proposed changes. Overall, according to ACIR, individual tax liability will be reduced by an average of 8.5%.

The current system of allowing for deductions of state and local tax payments has, according to ACIR, generally worked to the advantage of a small percentage of persons with high incomes living in states with high and steeply graduated tax rates. The two-thirds of Americans who do not itemize their deductions get no benefit at all from this provision, and end up subsidizing those who do. The average citizen in the 34 lower tax states ends up subsidizing high-income taxpayers in higher tax states. In other words, the current deduction causes a shift in federal income tax burdens, with higher income taxpayers in high-service, high-tax communities benefitting at the expense of average taxpayers in low-service, low-tax communities.

Opponents of the President's reform argue that it pits the 15 "high tax" states against the other 35. This charge suggests that such competition amongst states does not exist already. In fact, it does. There is competition amongst the states as Congress deals with federal programs and distribution formulas for new programs and revisits targeting for existing ones. Here is competition amongst the states in dealing with departments and agencies as each seeks to get its fair share, and more, of limited federal dollars in grants, etc. The majority of states have offices in Washington, D.C. to wage just such competition in the halls of Congress and amongst the federal agencies.

I am not suggesting such competition is bad, but rather to put in perspective and appropriately discount the charge that this reform somehow is wrongheaded because it heightens competition amongst the states. Tax deductibility is but one of the many areas where competition already exists for the approximately $150 billion in aid the federal government provides to state and local governments (grants-in-aid and tax deductibility).

Opponents of this reform also argue that the cruelest effect in "high tax" states would be on welfare programs and medicaid benefits for the poor. This charge is based on a false presumption that states and local governments, when faced with tough fiscal decisions, are somehow less compassionate than the federal government. In recent years, state and local governments have been faced with a significant federal retrenchment of grant-in-aid assistance and a recession that forced them to make extremely difficult budget decisions. The simple fact is that state and local governments faced these tough choices directly—even raising taxes as necessary—and with compassion. Both academic studies and press reports have clearly documented this phenomenon.

Then there is the cluster of charges critics make that the elimination of state and local tax deductibility will do damage to "federalism." They point out that if adopted, this reform proposal would abruptly end a pattern of federal-state relations that has governed policy-making for more than 70 years, since the begin-

ning of the modern income tax. They argue that we need to guard the vitality of state and local government, and this reform proposal would usurp still more traditional local tax sources for the federal treasury. And that, as costs rise, resistance to any kind of tax increase at the local and state level would be greater than now because the full weight would be felt by the individual taxpayer and not shared through deductibility with Washington.

It is important to guard the vitality of state and local governments. But, the overall pool of resources for state and local governments is much more dependent on a healthy economy than on deductibility.

A principal means to strengthen federalism is by sorting out responsibilities to provide for clearer accountability. That accountability, in turn, encourages greater citizen participation in government. If a citizen does not know who is responsible for what goes right or what goes wrong in government, he has less incentive to vote. After all, what difference does it make? Therefore, to move from cooperative federalism to sorting out responsibilities in our intergovernmental system has been recognized increasingly as a worthwhile federalism reform. The president's proposal to eliminate deductibility does just that.

Those who spend money at whatever level of government should bear the full political cost of raising the money they intend to spend. Citizens should be allowed to judge whether the full cost of their government at each level is justified by the services and benefits provided therefrom. Citizens then can exercise an informed judgment at the ballot box and take more control over their governments. This is not a chilling effect on state and local governments, but an invigorating one. For with clearer responsibility there can be more effective accountability and that is good in a democracy. More citizen participation invigorates local, state and federal governments.

Therefore, elimination of state and local tax deductibility can help not only create a simpler, more equitable tax system, but also further revitalize and strengthen our intergovernmental system.

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***Counterpoint***

# Deductibility and Federalism: The Ties That Bind

John J. Marchi

**Years from now, when historians chronicle The Great American Tax Reform Effort of 1985-86, some may be moved to wonder, in awe, just how our Founding Fathers ever managed to write a Constitution without benefit of CPAs, economists and tax laywers.**

The Henry Steele Commagers and Arthur Schlesingers of the future could hardly be blamed for raising the question. For a long time throughout the summer, fall and winter of 1985, the Treasury Department, the White House, and the House Ways and Means Committee seemed intent on keying tax code overhaul strictly to a financial theme. How, the queries went, can we achieve a true tax reformation that will not only reach the golden mean of fairness-growth-simplicity, but also flourish in a climate of revenue neutrality?

What troubled many New Yorkers—among them Alfonse D'Amato, Daniel P. Moynihan, Warren M. Anderson, Mario Cuomo, as well as myself—was the quest for revenue neutrality as the be-all and end-all. The crucial issue, as some of us saw it—for New York and all of our sister states—was the proposal first surfaced by the Treasury Department to eliminate state and local tax deductions from the federal income tax return.

The strictly fiscal approach in my judgment, and that of the gentlemen above named, missed the point entirely. Considering a tax code rewrite from a strictly financial perspective ignored the fact that the issue is really an institutional matter.

What confronts the Nation is something vastly more important than a statistical analysis and reaction. The statistics and their import animate and provide some of the substance involved. But, in reality, we are dealing with the institutional issue of federalism. Simply put, elimination of deductibility would demolish the federal system of government as we know it. Abolishing it would be the fastest road to double taxation and, inevitably "Big Brother", central government.

But the deductibility battle is far from over. Certainly there was cause for some optimism when the House Ways and Means Committee voted to preserve state and local deductions, in the "simplified", 1400-page bill it turned loose just before Thanksgiving. And President Reagan's epic pre-holiday exertions on Capitol Hill produced crucial Republican votes needed to pass the House version and send it to the Senate, with deductibility intact. Mr. Reagan pinned his hopes on a Senate overhaul to preserve the marrow and fiber of the plan he embraced last summer, a version that would chuck deductibility into the dustbin of history.

Whether any change in the deductibility provision would emerge intact from a Senate-House conference on the bill remains doubtful. Some reports suggested that the Senate might turn to a unitary or value-added tax.

But the House Ways and Means bill was clearly a step in the right direction. What would be unacceptable ultimately would be a bill that eliminates or shaves state and local deductibility, as Ways and Means Chairman Dan Rostenkowski first suggested.

The worst nightmare one can conjure is the development of a package drawn strictly with numbers in mind. What constitutional damage can the accountants, economists and tax lawyers do when tinkering with the statutes? More than enough to set Madison, Hamilton and Jay spinning in their graves and darkening their Federalist Valhalla.

For, if Congress yields to the frenzy of the moment to produce a system of double taxation of state and local taxes, the result will ultimately include exhaustion of the states' revenues and a decrease in their ability to provide basic services for the people. Given that dark scenario, the federal government would inevitably assume responsibility for some of these programs which states and local units can no longer afford.

And, irony of ironies, the eventual effect would be exactly the opposite of the decentralized government President Reagan hopes to leave us as his legacy. With the power of states drained financially and spiritually, a central government would emerge, swollen with

power and money. Is that to be the payoff for Valley Forge and all of the many other agonies of those eight long years?

Was the disallowance of state and local tax deductibility, with an estimated yield of $33 billion, going to actually solve our fiscal problems? Bear in mind that the interest on the United States debt alone amounted to over $149.2 billion in fiscal 1986. No, it was merely the equivalent of less than eleven weeks of interest on the national debt, exclusive of payment of principal and all defense and non-defense spending.

When we consider that state and local governments provide virtually all of the basic public services and account for 14 million of 17 million public sector employees, a mortal blow to those services is scarcely worth 11 weeks of improvident federal interest payments on the national debt.

Is that what George Washington and the other Founding Fathers had in mind when they drove King George's Redcoats from our shores in 1783?

If tax reform is going to involve alteration of the most basic compact under which we have lived for two centuries, let's forget doing it by statute. Instead, let Congress honor the request made by our New York State Senate to originate a constitutional amendment shield to protect state and local revenue vulnerability. And let Congress then submit that amendment to the states for consideration.

The way would then be clean to expose the sinister nature of taxation without deductibility. And perhaps then, with all the implications made starkly visible, we can write deductibility into the Constitution on a permanent basis—without benefit of accountants, tax lawyers or economists.

*John J. Marchi is Chairman, Committee on Finance of the New York State Senate.*

# Canadian Experience With the Representative Tax System

Douglas H. Clark

**The representative tax system (RTS) is used by the Government of Canada as a means of allocating federal grants to provinces on a basis of their relative need for financial assistance. The purpose of this article is to describe the role of the RTS within the Canadian system of intergovernmental grants.**

Canada, like the United States, is a federal country in which some public goods and services are provided by the national government and some by regional (provincial) and local governments. Each level of government imposes taxes and, by and large, finances the services it provides by means of these taxes. However, services may also be financed by grants from other governments.

There are some remarkable similarities between the federal systems of Canada and the United States. Thus, the differing services provided by the central and regional governments are similar in the two countries, as are the ranges of taxes levied. At the local governmental level the similarities are particularly marked. However, the two federal systems tend to diverge rather significantly in the case of intergovernmental grants. Thus, Canada places considerable emphasis on a type of grant not used by the United States Government, i.e., grants with no conditions imposed upon the receiving governments. Canada also emphasizes block grants with conditions of a very broad nature. The number of federal grant programs is much fewer in Canada than in the United States, but the total payments appear to be relatively twice as large.

### The Canadian System of Intergovernmental Grants

Like the United States, Canada has a well-established system of intergovernmental grants. There are large grants from the federal government to the provinces and from the provinces to local governments. Relatively small grants are paid from the federal government to local governments, but there can be little doubt that local governments—who are "creatures of the provinces"—benefit greatly from the system of federal-provincial grants.

There are various rationales for federal grants. Two are of particular importance. First, federal grants are paid because of a perceived "national" interest in certain services which are provided by provinces. Second, grants are paid to some provincial governments because of a perception that they are less able than others to provide the public services for which they are responsible.

In the 1985-86 fiscal year (ending March 31, 1986), federal cash grants to provincial and local governments will total an estimated $21 billion, or approximately 20% of total federal budgetary expenditures.[1] Approximately $13 billion of these grants is being paid for health, post-secondary education, and welfare programs administered by the provinces (including insured medical and hospital services), $5 billion for equalization payments to needy provinces, and $3 billion for a small number of other programs. (In order to put Canadian numbers such as these in terms of an American equivalent it is customary to multiply them by ten, given that the U.S. economy is approximately ten times as large as the Canadian.)

The allocation of federal grants among provinces is, of course, a matter of great importance. Some Canadian grants are allocated on an equal per capita basis. Some are distributed on a cost-sharing basis for certain defined expenditures. Equalization payments are allocated on a basis of need, that is defined in terms of disparities in the relative revenue-raising capacities of provinces. Various other methods of grant allocation also are used.

Six provinces, with approximately 40% of total provincial population, presently qualify for equalization. Four relatively well-off provinces, which have approximately 60% of total population, do not qualify. The distributional impact of the $5 billion in equalization payments on provincial revenues is therefore very large.

The importance of the equalization program to provinces is illustrated by *Chart I* that indicates the estimated proportions of total provincial revenues in 1985-86 accounted for by federal grants for health and education; welfare; and equalization.[2]

The remainder of this article will describe Canada's equalization program, and will deal with the central role of the RTS in this program and its further use in evaluating the fiscal health of the provincial-local government sector.

## CANADA'S EQUALIZATION PROGRAM

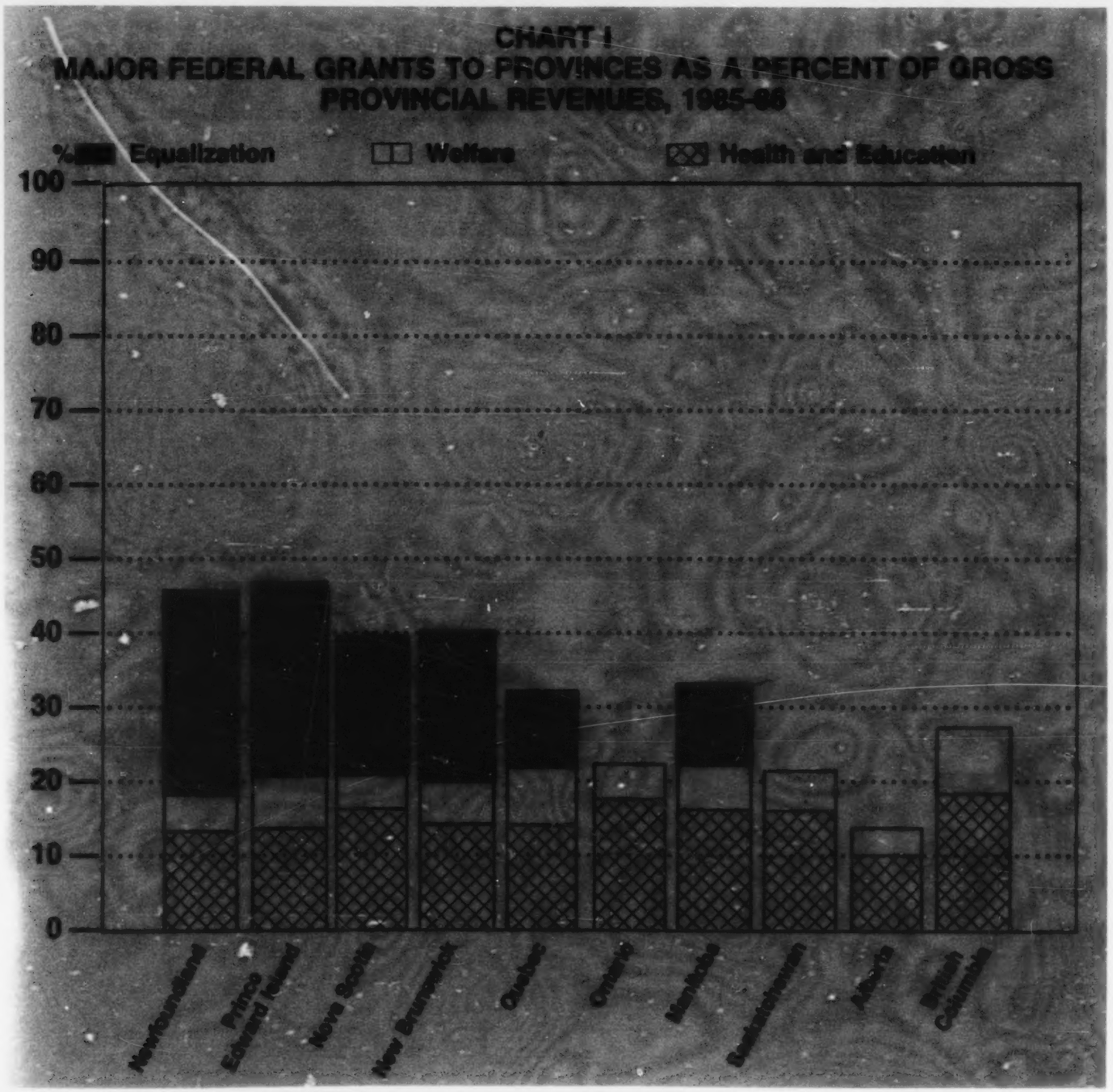
The purpose of Canada's equalization program is set out in section 36.(2) of the Constitution as follows:

> "Parliament and the Government of Canada are committed to the principle of making equalization payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation".

This provision was added to the Constitution in 1982. However, similar statements about the intent of the program go back to its origin in 1957, and indeed even earlier, to 1940, when the concept of equalization was first proposed by a Royal Commission.

Although equalization has a distinct purpose, program payments have always been made free of any conditions. Neither the federal government nor the provinces have considered that it would be appropriate for the federal government to specify levels of taxation or public services that provinces should provide. Any province receiving equalization is therefore free to use funds from this source to raise its levels of public services or to lower its levels of taxation, or some combination of the two.

The equalization program covers local as well as



provincial governments. This is done by collectively taking each province's municipalities and school authorities, etc., into account in determining its eligibility for equalization and the amount of any payment it receives. Although equalization payments are not made directly to local governments, it is inevitable that payments to an equalization-receiving province will, in one way or another, benefit its local governments.

The need for an equalization program in Canada arose for two reasons: first, because Canada is a federal state; and second, because Canada has had a persistent problem of regional economic disparities. As a consequence of these regional disparities, any given level of taxation will tend to raise more money in high-income provinces than in low-income provinces. In the absence of some countervailing action of the kind provided by an equalization program, the low-income provinces would normally have higher levels of taxation and/or lower levels of public services than the high income provinces, in some cases markedly so. Successive Canadian Parliaments have felt that such a situation would weaken Canadian unity, and political spokesmen have frequently referred to the equalization program as "the cornerstone of Canadian federalism".

The equalization program is not intended to address the underlying problem of regional economic disparities. Accordingly, payments are made to *governments* and are based upon the measured well-being of these governments as distinct from their residents. (In fact, it is possible, although not likely, for a particular region to have *residents* whose average incomes are relatively low but a *government* whose total per capita revenues from taxation—perhaps because of large natural resource rents—tend to be relatively high. In such circumstances, no equalization payment would be warranted.) While payments are made to governments, their ultimate impact is upon individuals since the well-being of individuals is influenced not only by their cash incomes, but also by the goods and services they receive from their provincial and local governments and the provincial and local taxes they pay.

### Calculation of Equalization Entitlements

Equalization is a "formula-based" program. Entitlements are calculated by a formula with three basic steps:

- Estimate the total amount of revenue per capita that each province could raise by imposing a *standard tax system*.
- Determine the level of revenue per capita to which each province is entitled to be raised. This is done by estimating the total amount of revenue per capita that a prescribed set of middle-rich provinces, known as "standard provinces", would obtain from the same standard tax system.
- Compare the per capita amounts from steps (1) and (2) for each province. If the amount under step (1) for any province is less than the amount under step (2), that province has a per capita equalization entitlement equal to the amount of its shortfall.

These steps are illustrated by *Chart II* and *Table 1*. *Chart II* indicates two important things about equalization. First, it illustrates how the equalization program got its name because it shows that, after taking account of equalization, the total per capita fiscal capacities of each of the eligible provinces are equal.

Second, *Chart II* demonstrates that the equalization formula has two basic elements:

FISCAL CAPACITY = the estimated per capita revenues that a province can obtain from imposing a standard tax system; and

**TABLE 1: CALCULATION OF EQUALIZATION ENTITLEMENTS, 1985-86**

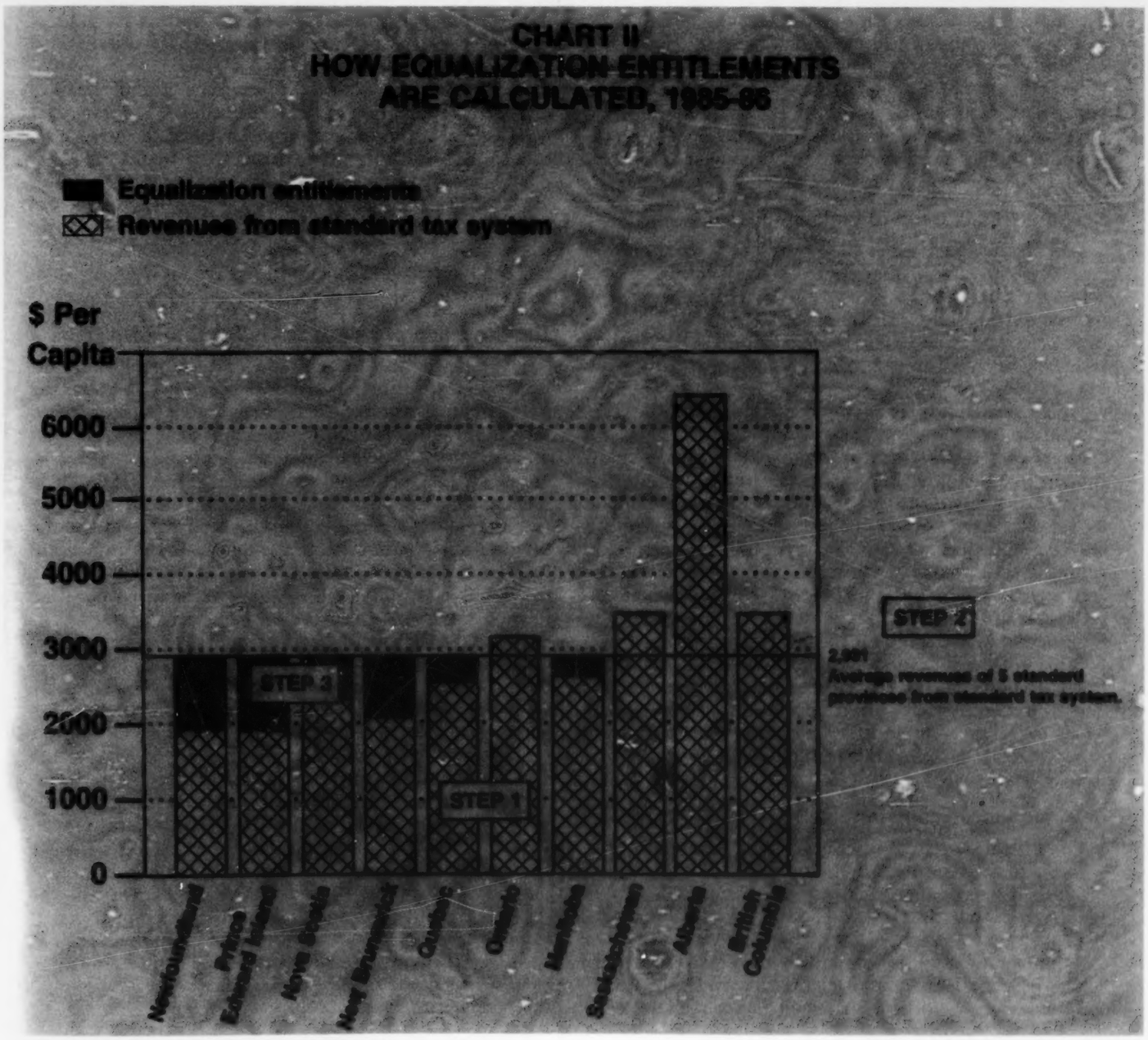
| Province | (1) Average Per Capita Yield of RTS in Standard Provinces | (2) Per Capita Yield of RTS in Province | (3) Per Capita Shortfall of Province from Standard Provinces (Col. 1 - Col. 2) | (4) Population | (5) Equalization Entitlement (Col. 3 x Col. 4) |
|---|---|---|---|---|---|
| | ($) | ($) | ($) | (000) | ($000,000) |
| Newfoundland | | 1,895 | 1,036 | 581 | 602 |
| P.E.I. | | 1,928 | 1,003 | 127 | 128 |
| Nova Scotia | | 2,284 | 647 | 881 | 570 |
| New Brunswick | | 2,129 | 802 | 719 | 577 |
| Quebec | | 2,516 | 415 | 6,581 | 2,734 |
| Ontario | | 3,110 | — | 9,064 | — |
| Manitoba | | 2,579 | 352 | 1,070 | 377 |
| Saskatchewan | | 3,321 | — | 1,019 | — |
| Alberta | | 6,333 | — | 2,348 | — |
| British Columbia | | 3,310 | — | 2,891 | — |
| Total | 2,931 | | | 25,281 | 4,988 |

EQUALIZATION STANDARD = the estimated average per capita revenues that the standard provinces can obtain from the same tax system—a level to which all provinces are entitled to be raised by the equalization program, and one that is considered sufficient to make it possible for all provinces to provide their residents with reasonably comparable public services if they levy reasonably comparable taxes.

Both fiscal capacity and the equalization standard are determined with reference to a standard tax system. This leads to consideration of the RTS because the standard tax system that is used to determine Canadian equalization entitlements is the RTS.

## THE CANADIAN REPRESENTATIVE TAX SYSTEM

The Candian equalization program was introduced in 1957, at one of the quinquennial renewals of what are known as the "federal-political fiscal arrangements". Prior to that time, these arrangements had related mainly to a cooperative system for sharing revenues from the personal income tax, the corporation income tax, and the estate tax. The original equalization formula was limited to these three taxes, but was in effect a "mini-RTS" that incorporated highly reliable data on tax yields derived from the revenue sharing system. The equalization program was widely accepted, and in 1967 was enlarged to take account of



all provincial taxes on income, consumption, property and natural resource rents, as well as various licenses, fees and service charges.

While local government revenues were excluded from the enlarged equalization program in 1967, it is fair to say that a comprehensive RTS was put in place at that time. In taking the decision to adopt the RTS, Canada was profoundly influenced by pioneering work on the concept by the Advisory Commission on Intergovernmental Relations, set out in a 1962 publication entitled *Measures of State and Local Fiscal Capacity and Tax Effort*.

The original Canadian RTS may be referred to as "RTS 1967" and it was suceeded, at five-year intervals, by RTS 1972, RTS 1977 and RTS 1982. The latter is presently in effect and will apply until its expiry in 1987. Each of these representative tax systems has been based upon the concept of devising a tax system that would be typical, in both rates and structures, of all of the taxes, licenses and fees, etc., currently levied by provincial, or provincial and local, governments. School purpose taxes were added to the system in 1973. Municipal taxes, together with local government revenues from sales of goods and services, were added in 1982. The Canadian system goes somewhat beyond pure taxation revenues, and can appropriately be referred to as a "representative revenue system". However, this term is not used in Canada.

### How the RTS is Used to Estimate Fiscal Capacity

The fiscal capacities of each province have therefore been estimated by means of successively defined representative tax systems since 1967. This has been done by estimating the total amount of revenue that each province could raise each fiscal year from the RTS then in effect. Such estimates are made separately for each tax and non-tax source of revenue. (For convenience, we refer to each kind of revenue as a "tax" whether it is a genuine tax, a quasi-tax, or a non-tax.)

More specifically, the procedure to estimate fiscal capacity is as follows. For each tax in the system, the *average provincial tax rate* for the fiscal year is applied to the estimated value of each province's standardized *tax base* for that source. The average provincial tax rate is determined by dividing the total revenues of the ten provinces from a tax by the total tax base of the ten provinces for that tax, as measured for purposes of the RTS. The tax base is determined with reference to a definition that is intended to be typical of the various bases actually used by provinces for that tax. The resulting revenue yields from applying tax rates to tax bases are then summed for each province to give its total estimated yield for the RTS—that is, its "fiscal capacity".

### Revenue Classification in the Canadian RTS

The initial step in applying an RTS, and one that is sometimes overlooked, is the classification of provincial-local revenues into categories or sources. Ideally, a separate revenue source should be established for every kind of tax which has a distinctive distribution of tax base among the ten provinces.

The present RTS has 39 categories and comes reasonably close to meeting this ideal. The RTS established in 1967 had only 16 revenue sources. This has increased gradually over the years to the present number. Some revenue categories have been added as a result of enlargement of the equalization program by the federal government. Others have been added to take account of new revenue sources developed by provinces, such as lotteries and payroll taxes. However, most of the new categories have stemmed from efforts to improve the quality of inter-provincial comparisons. For example, in 1977 revenues from alcoholic beverages were split into separate sources for spirits, wine and beer in order to reflect the varying degrees to which provinces can derive revenues from these products owing to differences in the elasticity of demand and also their regionally-distinctive patterns of consumption. Similarly, in 1982 a special category was established for heavy oil because its economic rent tends to be less than that from conventional oil, and there are distinctive patterns of regional production, with heavy oil being concentrated in Saskatchewan and conventional oil in Alberta. Quite a number of natural resource revenue categories have been added for similar reasons.

Natural resources account for almost half of the total number of categories in the present RTS. This is partly a reflection of the importance of natural resources as a source of inter-provincial disparities in Canada and partly a reflection of the well-known tendency of natural resources of any kind to have a unique geographical incidence. One reason for the importance of natural resources as a source of provincial revenues is that most sub-surface rights to minerals in Western Canada are owned by provincial governments.

### The Definition of Tax Bases in the Canadian RTS

The most important element in measuring fiscal capacity is the definition of tax bases, since it is the tax base amounts which determine how rich or poor a province is, whether it qualifies for equalization, and if so, by how much. A definition must be made for each revenue category. This has proven to be a difficult, technical task, in part because each tax base must reflect the increasingly complicated tax structures of the ten provinces. Fortunately, problems with the important income taxes have been minimized because the ten provinces continue to levy personal and corporation income taxes on a remarkably uniform basis that is closely tied to the federal system. Other taxes frequently present more difficulties. The various tax base definitions have been worked on over a period of some 20 years, and many of the most difficult problems have been resolved in a satisfactory manner. Of course, problems remain. At the present time, work is being done on a number of tax bases, including those for property taxes, general sales taxes, and lotteries. This work is done in close consultation with the provinces. Inevitably, however, there is a continuing need for some changes to tax bases because each annual round of provincial budgets tends to bring changes in the typical structure of some provincial taxes. For this reason alone, the RTS will always need periodic updating.

*Table 2* provides a brief summary of the 39 revenue categories in the present RTS and the accompanying tax base definitions.

## TABLE 2: SUMMARY OF THE 1982 RTS

| Type of Revenue | Number of Revenue Sources | Summary of Tax Base Definition |
|---|---|---|
| Personal income tax | 1 | Total simulated yield in province of the average provincial personal income tax rate applicable to each tax bracket as these brackets are defined for purposes of federal tax. (This is done by a federal personal income tax model.) |
| Corporation income tax | 1 | Portion of taxable income of corportions allocated to province by a *standard allocation formula* set out in the Income Tax Regulations and accepted by all provinces. |
| Consumption taxes (general sales taxes, taxes on gasoline, alcohol, tobacco, etc) | 9 | Value or volume of consumption in the province of taxable good or service. |
| Property taxes | 1 | Value of buildings included in capital stock in province for *building component* of property taxes; gross provincial product, with some adjustments, used for *land component* of property taxes. |
| Taxes on natural resource rents | 18 | Value or volume of production in the province of natural resource in most cases; actual revenues of province from resource used in two cases. |
| Estate taxes | 1 | Total income of high income taxpayers in province, with increased weight for taxpayers aged 65 and over. |
| Taxes on corporation capital | 1 | Value of those elements of corporation capital that are typically taxed, such as equity capital, reserves and long-term debt—with higher weight for amounts attributable to financial institutions. |
| Health insurance premiums | 1 | Estimated number of persons liable for typical premium in province. |
| Payroll taxes | 1 | Value of wages and salaries paid in province. |
| Lotteries | 1 | Personal disposable income in province, with some adjustments. |
| Motor vehicle licenses, non-commercial | 1 | Number of passenger vehicle registrations in province. |
| Motor vehicle licenses, commercial | 1 | Value of capital stock of vehicles sold in province over five year span. |
| Miscellaneous taxes and non-tax revenues | 2 | Weighted average of province's tax bases for all non-resource revenue sources; actual revenues of province for one minor source. |

Some of the tax bases listed in *Table 2* are not the statutory bases that are actually used by provinces or local governments, but rather proxies for the actual bases. If a proxy base has a distribution among provinces that is similar to the distribution of the typical actual base, it should produce a result that will be similar to the result that would be obtained if the actual base could be used. This is important because statistical data are sometimes not available for actual tax bases on a uniform basis for all provinces.

Estate taxes provide an example of a proxy base. The actual tax base for estate taxes (actually known as "succession duties" when levied by provinces) has been the value of the estate or of the bequest. Provinces have been withdrawing from this field, and there are no longer suitable data on estates or bequests that could be used for purposes of intergovernmental comparison. However, there are good data on the total income of persons in high tax brackets, with separate data for persons aged 65 and over, from which a suitable proxy base can be developed. Where it is necessary to employ a proxy base, every effort is made to use one that is supported by statistics of good quality for purposes of inter-provincial comparisons.

### Population

One final element of the RTS is population. Population is used to compare provinces of different size, and is a measure of provincial expenditure need—it being assumed that, on an overall basis, such needs are equal per capita for all provinces. As a consequence, population is undoubtedly the important single input into the equalization formula. Fortunately, Canadian population data appear to be of good quality. Annual data are related to census benchmarks, and a census is taken every five years. In addition, considerable attention has been given in census planning to means of reducing the extent of a phenomenon known as "census under-enumeration"; i.e., the number of people who, for any reason, are not counted in a census.

### Alternative to the RTS

The RTS is not the only means of estimating provincial fiscal capacities. From the very beginning, consideration has been given in Canada to the use of an alternative which would be based upon some broad "macro concept" of provincial income or provincial product. In the 1950s, attention focused on the concept of *personal income*, for which data were readily available. In the 1960s and early 1970s, attention focused on a *weighted combination of personal income and corporation taxable income* which took account of the relative proportions of provincial taxes paid by individuals and business enterprises. More recently, interest has shifted to *gross domestic provincial product*, which has been published each year by Statistics Canada beginning with 1977. Although the latter series is published on an "experimental basis", most of its components are considered to be of good quality and it has been used in both RTS 1977 and RTS 1982 as a proxy for certain tax bases which relate very broadly to economic activity.

The Canadian rationale for choosing a representative tax system essentially has been that this reflects the real world of what provinces collectively choose to tax. Accordingly, it gives the most weight to those things which provinces tax most heavily, such as:

- consumer goods for which there is an inelastic demand—such as gasoline, beer, tobacco and lottery tickets (but not food because provinces choose not to tax it);
- real property—because it is immovable, making tax evasion almost impossible;
- economic rents—especially from natural resources (which can be taxed without affecting output decisions or giving rise to a misallocation of the factors of production);
- non-residents—for example, the application of retail sales taxes to goods and services that tourists are known to buy heavily.

The latter two categories both relate to a phenomenon known as the "exportation of taxes"—a matter that the RTS automaically takes into account.

Macro-concepts of fiscal capacity do not, and are not intended to, recognize distinctions collectively made by provinces in their actual systems of taxation. As a result, these concepts fail to reflect adequately the uneven provincial distribution of many things that are taxed heavily and they do not provide a sensitive measure of fiscal capacity.

The advantage of the RTS can be stated in another way. The RTS provides a direct measure of the fiscal capacity of *governments*, whereas macro-measures of capacity relate to the capacity of the total economies over which governments have jurisdiction. Since grants such as equalization are paid to governments, there is a *prima facie* case for basing them upon a fiscal capacity measure such as the RTS that relates to governments. However, there is a continuing recognition in Canada that macro-concepts of fiscal capacity have advantages. For example, they are considered to be more "neutral" because they are less likely to influence the behavior of provincial governments or to be biased by certain actions that provinces may take. Macro-concepts are therefore likely to continue to be considered at each quinquennial renewal of the equalization program.

If gross domestic provincial product or some other macro-economic measure were to be used to measure fiscal capacity, the concept of a "standard tax system" as illustrated in *Chart II* could be retained, but in this event, the same measure of tax base would be used for each tax in respect of which equalization is calculated. There would then be no need to classify provincial-local revenues into sources.

### Other Uses of the RTS

The RTS provides data inputs which make important fiscal comparisons among provinces possible. Accordingly, indices of fiscal capacity and of tax effort, of the kind that the Advisory Commission on Intergovernmental Relations now calcualtes in the United States, are produced following every official calculation of equalization. In addition, indices of fiscal capacity are produced, *post-equalization*, which indicate the striking effect that this program has on reducing disparities among provinces. The various indices help

governments monitor the state of horizontal fiscal balance in the Canadian federation and are useful for general policy purposes.

Apart from equalization, indices of fiscal capacity have also been used in some relatively small federal-provincial programs where it is intended to provide benefits to provinces that have revenue-raising capacities below certain specified levels.

## CONCLUSIONS

Canada has successfully operated an RTS since 1967. The RTS is built into Canada's large equalization program which provides annual financial support, with no strings attached, to financially-disadvantaged provinces on a formula basis. The purpose of these grants is to make it possible for all provinces to provide reasonably comparable levels of public services at reasonably comparable levels of taxation. The RTS is used to allocate equalization payments because it is considered to provide the most sensitive and realistic means of comparing provinces in respect of their revenue-raising capacities. The present RTS takes account of all provincial and local taxes and almost all other provincial-local revenues from own sources.

### Footnotes

[1]In addition, the federal government transfers a further amount to provinces of approximately $7 billion (for health, education and welfare) in a form known as a "tax transfer". A tax transfer is a transfer of "tax room" by one level of government to another, which is achieved by one level of government reducing its rates for one or more kinds of tax in order that another level of government can make a corresponding increase in its own rates for the same taxes, without there being any change in the overall burden on the taxpayer.

[2]Chart I includes tax transfers for health, education and welfare, as well as cash transfers for these programs and for equalization.

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A Fiscal Note

# Tax Reform and Federal Individual Income Tax Liabilities

**Carolyn D. Lynch**
**Analyst**

As part of a larger study on the fiscal effects of comprehensive tax reform of the the federal income tax structure on state and local governments, the Advisory Commission on Intergovernmental Relations (ACIR) is analyzing the impact of various tax reform proposals on federal income tax liabilities. The research was supported in part by a grant from the Ford Foundation.

The purpose of this analysis is to determine how the various tax reform plans would affect the federal income tax liability of citizens in different states and income classes. Preliminary information is now available on how the President's and the House-approved plans would affect federal personal income taxes on a state-by-state basis.

The ACIR has contracted with deSeve Economics Associates to provide the data necessary to analyze the effects of federal tax reform. The data supplied by deSeve Economics are based on microsimulation modelling of the federal income tax system. The data base used in the computer simulation by deSeve Economics is conceptually the same data file that the U.S. Department of the Treasury and the Joint Tax Committee use as their primary data source for analysis and revenue estimates of all federal individual income tax changes.[1] The number of records in the deSeve data base, however, is substantially larger and, therefore, permits the calculation of meaningful results on a state-by-state basis. The statistical procedures employed in the development of the deSeve data base used projections of the national economy based on the Administration's (February 1985) economic forecasts.

Both tax reform plans contain some provisions that would increase federal tax liability over current law and others that would decrease liability. It is the net effect of these two types of changes, when they are combined in a comprehensive reform plan, that determines whether a particular tax reform proposal increases or decreases tax liability, or leaves it unchanged. It is important to note that certain provisions of both the President's and the House-approved plans cannot be caputred by microsimulation techniques. For both plans, it was possible to estimate the effects of approximately 98% of the revenue-losing provisions and 73% the revenue-gaining provisions. This means that the estimated changes in tax liability derived from the microsimulations are overstated by approximately 25% in both cases. The simulated national reduction in personal income tax liability is 9.2% under the President's proposal and 9.6% under the House-approved plan. When the figures are adjusted for the 25% overstatement, total federal personal income tax liability is estimated to fall by 6.9% under the President's plan and 7.2% under the House-approved plan.

### The Differential Impact of the Two Plans

A state-by-state comparison of the impact of the President's and the House-approved tax reform proposals on federal individual income tax liabilities is presented in the table on pages 32-33. The effect of the two reform plans on federal personal income taxes paid by all residents of a state, and a breakdown for five income classes within each state, are given. The preliminary estimates are based on 1986 levels of income and are designed to present the permanent or fully phased-in effects of all provisions of the tax reform plans, even though some provisions would not actually take full effect until years subsequent to 1986. Federal individual income tax liabilities were estimated for five income classes within each state under current federal tax law and for each of the two reform plans. From these estimates, the percent changes in federal income tax liabilities from current law for each income class and reform plan were calculated. The figures in the column headed "weighted average of all classes" are based on estimates of aggregate federal income tax liabilities under current law and the two reform plans for all residents of a particular state. The figures, therefore, indicate the average change in liabilities for all taxpayers of that state.

Total federal individual income tax liabilities for the entire nation are estimated to decline by approximately 9% under both the President's and House-approved tax reform proposals.[2] The reduction in federal individual income taxes, however, would vary considerably by income class and by state under the two plans. Under the Administration's proposal, the decline in aggregate federal income tax liabilities would range between −15.0% for Alaska to −2.9% for Minnesota, a difference of 12.1 percentage points.[3] The House-approved plan demonstrates

a range of about one-half that of the Administration's plan. The variation across states under the House bill would range between −13.2% for Tennessee to −6.2% for Idaho, a difference of 7.0 percentage points.

### The Role of the Deduction for State and Local Taxes

While further analysis must be done to determine how the various provisions under each plan affect the changes in federal personal income taxes, the treatment of the deduction for state and local taxes is likely to explain a fairly substantial portion of the differential impact of the two plans across states.[4] Taxpayers residing in a state with high state and local taxes, such as New York, would, on average, experience a 4.9% decline in federal income tax liabilities under the President's plan, and an 8.8% decline in individual income taxes under the House bill. In contrast, the average decline in federal individual income tax liabilities in Connecticut, a state with a below average state and local tax burden, would be 11.3% under the Administration's plan and 10.4% under the House plan.

The interstate differences for a given plan become even more dramatic for high-income earners, due largely to the differing treatment accorded the payment of state and local taxes, in general, and state and local income taxes, in particular. The fact is underscored by the data set forth comparing New York, which relies heavily on a personal income tax, and Connecticut, a state that does not have a broad-based income tax (see box).

It should be noted that the data presented here are based on total federal individual income taxes paid by all residents of a particular state or income class within the state. The percent changes, therefore, indicate the average change in liabilities for all taxpayers in a given state or income class within that state. The tax liability of any one taxpayer residing in a particular state or income class, however, will depend on many factors that are unique to that individual and, therefore, may vary substantially from the average change in taxes paid by all individuals in a given income class or state.

**Interstate Tax Difference for Income Taxpayers in the $50,000-$99,9999 Income Class: Percent Change in Federal Liabilities from Current Law**

| | The President's Plan | The House Plan |
|---|---|---|
| New York | +1.8% | −5.4% |
| Connecticut | −10.8% | −8.0% |

**Footnotes**

[1]The deSeve data base was constructed by merging tax return data from the Statistics of Income file generated annually by the Internal Revenue Service with demographic data from the Current Population Survey. In addition, pertinent information from several other sources on such items as fringe benefits and employer paid benefits has been statistically imputed to each record.

[2]This estimate and those stated below are somewhat overstated. See the explanation given above and on the table on pages 32-33.

[3]These figures are presented in the columns headed "weighted average of all classes."

[4]The President's proposal repeals the provision allowing the deduction for state and local taxes. In contrast, the House-approved plans sets a floor under all itemized deductions of $500 per personal exemption, i.e., all deductions above an amount equal to $500 times the number of personal exemptions would be allowed. State and local taxes are a major itemized deduction.

# PRELIMINARY ESTIMATES OF CHANGES IN 1986 TOTAL FEDERAL PERSONAL INCOME TAX LIABILITIES UNDER THE PRESIDENT'S AND HOUSE-APPROVED TAX REFORM PROPOSALS BY INCOME CLASS*

| | PERCENT CHANGE FROM CURRENT LAW: THE PRESIDENT'S PLAN[a] | | | | | | PERCENT CHANGE FROM CURRENT LAW: THE HOUSE PLAN[a] | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | INCOME CLASS | | | | | | INCOME CLASS | | | | |
| | Weighted Average of All Classes[b] | 10,000— 19,999 | 20,000— 29,999 | 30,000— 49,999 | 50,000— 99,999 | 100,000 | Weighted Average of All Classes[b] | 10,000— 19,999 | 20,000— 29,999 | 30,000— 49,999 | 50,000— 99,999 | 100,000 |
| **New England** | | | | | | | | | | | | |
| Connecticut | -11.3% | -8.8% | -9.3% | -10.6% | -10.8% | -12.4% | -10.4% | -12.1% | -8.0% | -11.5% | -8.0% | -10.2% |
| Maine | -8.4% | -11.9% | -8.3% | -7.0% | -7.7% | -7.4% | -11.8% | -20.8% | -13.3% | -9.9% | -9.6% | -7.9% |
| Massachusetts | -9.4% | -7.3% | -9.6% | -7.8% | -6.3% | -12.3% | -9.8% | -12.5% | -10.1% | -9.3% | -7.6% | -9.5% |
| New Hampshire | -11.0% | -9.8% | -10.0% | -9.9% | -11.5% | -12.2% | -10.9% | -15.4% | -10.0% | -11.9% | -9.3% | -7.6% |
| Rhode Island | -8.6% | -11.0% | -9.4% | -10.2% | -3.4% | -8.0% | -10.6% | -18.9% | -9.7% | -11.9% | -5.1% | -7.4% |
| Vermont | -9.8% | -10.9% | -8.2% | -10.4% | -7.4% | -10.0% | -10.6% | -16.1% | -9.8% | -12.7% | -7.0% | -8.1% |
| **Mideast** | | | | | | | | | | | | |
| Delaware | -5.9% | -9.7% | -3.4% | -3.5% | -5.8% | -6.8% | -8.9% | -15.5% | -5.8% | -6.4% | -8.6% | -9.3% |
| Washington, DC | -7.8% | -13.1% | -10.2% | -6.2% | -1.7% | -9.2% | -8.7% | -19.7% | -10.6% | -8.3% | -4.9% | -6.7% |
| Maryland | -7.3% | -10.7% | -7.4% | -3.4% | -6.6% | -10.2% | -9.0% | -18.4% | -8.8% | -7.6% | -7.3% | -8.6% |
| New Jersey | -10.1% | -14.2% | -8.0% | -9.2% | -7.4% | -12.0% | -10.6% | -21.9% | -10.0% | -10.0% | -7.9% | -9.6% |
| New York | -4.9% | -12.1% | -7.9% | -2.6% | 1.8% | -6.8% | -8.8% | -18.4% | -8.8% | -7.4% | -5.4% | -8.6% |
| Pennsylvania | -9.9% | -10.4% | -9.0% | -9.2% | -8.2% | -12.0% | -10.4% | -16.1% | -9.5% | -10.6% | -8.1% | -9.0% |
| **Great Lakes** | | | | | | | | | | | | |
| Illinois | -10.7% | -10.8% | -8.1% | -8.9% | -9.7% | -13.6% | -10.3% | -15.8% | -8.5% | -9.5% | -8.7% | -10.0% |
| Indiana | -11.6% | -11.5% | -6.9% | -10.5% | -11.8% | -14.3% | -11.2% | -18.8% | -9.0% | -10.9% | -9.6% | -9.8% |
| Michigan | -7.2% | -10.8% | -7.2% | -5.8% | -4.6% | -10.6% | -9.9% | -19.4% | -9.0% | -9.6% | -7.5% | -9.0% |
| Ohio | -10.5% | -10.0% | -10.9% | -9.9% | -9.0% | -11.8% | -10.5% | -15.1% | -11.9% | -11.0% | -8.3% | -8.0% |
| Wisconsin | -5.0% | -9.3% | -8.3% | -5.4% | -1.9% | -1.1% | -9.2% | -14.5% | -9.5% | -9.5% | -5.9% | -8.7% |
| **Plains** | | | | | | | | | | | | |
| Iowa | -7.6% | -9.4% | -4.9% | -6.0% | -4.9% | -12.1% | -8.9% | -11.7% | -6.5% | -8.0% | -7.6% | -9.9% |
| Kansas | -8.5% | -7.8% | -6.1% | -8.0% | -7.0% | -10.5% | -8.4% | -13.9% | -6.8% | -9.9% | -6.5% | -6.9% |
| Minnesota | -2.9% | -7.4% | -5.5% | -2.2% | 2.1% | -4.3% | -6.9% | -9.5% | -6.4% | -6.3% | -5.2% | -6.3% |
| Missouri | -10.0% | -10.2% | -6.1% | -9.1% | -10.0% | -11.6% | -9.9% | -16.5% | -5.7% | -10.6% | -8.6% | -7.8% |
| Nebraska | -9.1% | -5.2% | -5.0% | -8.7% | -10.0% | -11.4% | -8.3% | -9.2% | -5.3% | -9.3% | -8.1% | -6.7% |
| North Dakota[c] | - | - | - | - | - | - | - | - | - | - | - | - |
| South Dakota[c] | - | - | - | - | - | - | - | - | - | - | - | - |
| **Southeast** | | | | | | | | | | | | |
| Alabama | -10.5% | -11.5% | -6.9% | -10.2% | -7.7% | -13.3% | -10.8% | -21.4% | -8.4% | -10.1% | -5.4% | -9.0% |
| Arkansas | -11.5% | -14.6% | -9.9% | -11.0% | -8.8% | -11.7% | -11.4% | -23.9% | -11.0% | -10.8% | -6.8% | -6.9% |
| Florida | -12.8% | -12.7% | -9.4% | -11.5% | -12.0% | -14.5% | -9.8% | -18.5% | -9.2% | -10.2% | -6.8% | -8.0% |
| Georgia | -9.0% | -14.2% | -8.8% | -6.9% | -5.1% | -11.1% | -11.4% | -23.6% | -11.7% | -8.6% | -7.0% | -9.1% |
| Kentucky | -9.3% | -11.0% | -6.2% | -6.4% | -8.5% | -14.3% | -10.5% | -20.5% | -7.7% | -8.2% | -7.7% | -10.7% |
| Louisiana | -14.7% | -17.7% | -10.7% | -12.5% | -14.2% | -16.5% | -12.2% | -24.9% | -11.0% | -10.6% | -10.9% | -10.2% |
| Mississippi | -12.2% | -20.8% | -9.6% | -10.3% | -10.4% | -11.4% | -12.2% | -32.8% | -11.7% | -9.7% | -8.5% | -5.3% |
| North Carolina | -8.2% | -12.4% | -6.2% | -8.1% | -4.2% | -8.7% | -10.3% | -21.5% | -10.6% | -10.3% | -5.7% | -5.3% |
| South Carolina | -9.9% | -13.6% | -6.9% | -7.2% | -7.2% | -12.5% | -11.6% | -22.6% | -8.9% | -8.6% | -8.3% | -9.6% |
| Tennessee | -13.7% | -17.8% | -10.3% | -12.0% | -13.6% | -14.0% | -13.2% | -30.7% | -11.3% | -11.9% | -9.1% | -9.5% |
| Virginia | -8.2% | -12.5% | -7.1% | -6.4% | -6.3% | -10.1% | -9.3% | -19.5% | -8.6% | -8.0% | -8.2% | -7.2% |
| West Virginia | -12.3% | -12.1% | -11.9% | -12.9% | -10.3% | -12.0% | -12.7% | -17.9% | -12.5% | -13.9% | -9.7% | -8.8% |

| | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Southwest | | | | | | | | | | | | |
| Arizona | -8.0% | -11.6% | -5.7% | -6.8% | -5.4% | -10.2% | -8.5% | -18.4% | -5.8% | -7.9% | -5.9% | -7.0% |
| New Mexico | -10.8% | -10.7% | -9.9% | -8.7% | -10.3% | -12.7% | -10.2% | -20.0% | -10.3% | -9.6% | -5.1% | -7.7% |
| Oklahoma | -9.3% | -8.8% | -6.4% | -7.1% | -8.2% | -11.4% | -8.3% | -14.8% | -6.0% | -7.8% | -6.7% | -6.5% |
| Texas | -13.9% | -14.6% | -11.0% | -12.2% | -12.8% | -15.7% | -10.5% | -22.8% | -11.2% | -10.8% | -7.4% | -8.4% |
| Rocky Mountain | | | | | | | | | | | | |
| Colorado | -7.9% | -9.9% | -4.7% | -3.7% | -7.1% | -12.4% | -7.1% | -13.6% | -5.4% | -5.6% | -6.4% | -6.7% |
| Idaho | -5.4% | -6.4% | -4.7% | -4.0% | -5.2% | -4.7% | -6.2% | -10.6% | -5.3% | -7.4% | -5.7% | -0.5% |
| Montana[c] | - | - | - | - | - | - | - | - | - | - | - | - |
| Utah | -6.5% | -11.2% | -6.7% | -4.0% | -2.6% | -10.0% | -8.6% | -18.3% | -8.1% | -7.8% | -5.3% | -6.0% |
| Wyoming | -11.8% | -11.0% | -6.5% | -12.0% | -11.0% | -13.2% | -7.5% | -16.7% | -4.3% | -8.8% | -5.7% | -4.8% |
| Far West | | | | | | | | | | | | |
| California | -5.9% | -11.2% | -7.1% | -4.7% | -1.4% | -7.7% | -7.5% | -18.4% | -6.9% | -6.4% | -4.6% | -6.8% |
| Nevada | -12.0% | -12.6% | -9.1% | -11.1% | -12.6% | -12.6% | -9.6% | -20.0% | -4.5% | -8.4% | -7.9% | -6.2% |
| Oregon | -3.0% | -9.4% | -1.0% | -1.9% | 1.6% | -6.5% | -6.5% | -14.9% | -3.5% | -6.3% | -4.6% | -5.4% |
| Washington | -12.1% | -13.0% | -7.5% | -10.3% | -11.6% | -16.7% | -9.6% | -17.9% | -6.7% | -8.7% | -7.9% | -10.5% |
| Alaska | -15.0% | -11.7% | -8.9% | -13.2% | -15.0% | -17.7% | -8.1% | -13.7% | -7.2% | -7.1% | -7.5% | -8.3% |
| Hawaii | -5.0% | -11.0% | -6.8% | -5.1% | -1.2% | -5.0% | -7.8% | -16.2% | -8.1% | -8.5% | -6.4% | -2.6% |
| United States | -9.2% | -11.6% | -8.1% | -7.8% | -6.7% | -11.2% | -9.6% | -18.4% | -8.9% | -9.2% | -7.1% | -8.3% |

*The percent changes are based on the total federal individual income tax liabilities of all taxpayers in a given income class and, therefore, represent the average change in liabilities for all taxpayers of a particular income class. The tax liability of any one taxpayer, however, will depend on many factors unique to that individual and may vary substantially from the average change in taxes paid by all individuals in the same income class. Federal adjusted gross income is used to define income class.

THESE NUMBERS ARE PRELIMINARY AND SUBJECT TO CHANGE.

[a]The estimated decline in taxes for the entire nation, of approximately 9%, overstates the nationwide tax reduction by about 25%, or roughly 2 percentage points in the case of each reform proposal (see below). Because of modelling and data limitations, it is not possible to make a corrective adjustment for each state. These preliminary estimates are based on microsimulation modelling of the federal income tax code by deSeve Economics Associates. The deSeve data base is conceptually the same as that used by the U.S. Department of the Treasury and the Joint Tax Committee for analysis and revenue estimates of federal individual income tax changes. The number of records in the deSeve data base, however, is substantially larger and, therefore, permits the calculation of meaningful results at the state level. The Administration's (February 1985) economic forecasts of the national economy were used to expand the data base. All estimates are based on 1986 projected levels of income and are designed to present the fully phased-in effects of all provisions of the tax reform plans. It is important to note that the figures supplied by deSeve Economics overstate the decline in federal individual income tax liabilities because certain tax provisions cannot be captured by microsimulation techniques. For each plan, approximately 98% of the revenue-losing provisions and 73% of the revenue-gaining provisions are covered by these simulations.

[b]This weighted average includes the income class of less than $10,000 that is not included on this table. The nationwide decline in federal income tax liabilities for this income class under the President's plan and the House plan would be −57.7% and −76.8%, respectively.

[c]The estimated data for this state are not yet available.

SOURCE: ACIR staff compilation based on data provided by deSeve Economics Associates. This research was funded in part by the Ford Foundation.

*Note*: These estimates may vary from other sources for several reasons. Estimates of the effects of proposed changes in the federal tax code may be based on economic forecasts from different sources and may be updated routinely due to changing economic conditions. In addition, the estimates presented here are designed to show the fully phased-in effects of all provisions of the tax reform proposals even though some have grandfather clauses or would not be fully phased-in until years subsequent to 1986.

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Summer 1986, Vol. 12, No. 3

# Intergovernmental PERSPECTIVE

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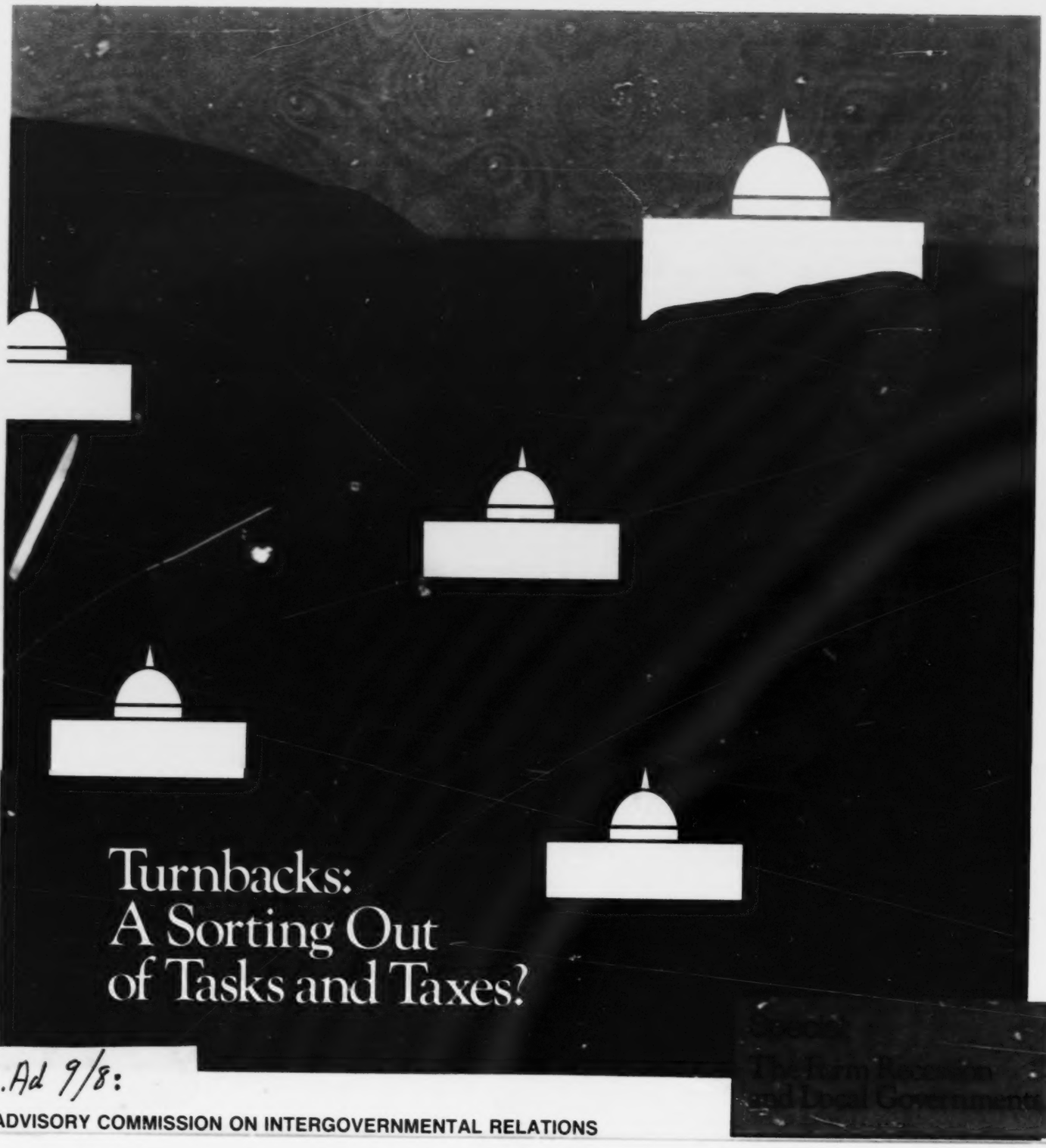

## Turnbacks: A Sorting Out of Tasks and Taxes?

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**(August 1986)**

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## In This Issue . . .

This Summer 1986 issue of *Intergovernmental Perspective* highlights the theme "Turnbacks: A Sorting Out of Tasks and Taxes?". In our Point-Counterpoint feature, ACIR Chairman Robert B. Hawkins, Jr. writes in support of the turnback of federal programs and tax sources to state and local governments, and Commission Member Joseph P. Riley, Jr. offers an opposing view. . . . The Special Report looks at the effects of the farm recession on local governments and summarizes the findings of a recent ACIR staff information report on this important public policy issue. . . . A new ACIR service—government finance data for individual cities and counties on microcomputer diskettes—is described and ordering information is provided. . . . Our Fiscal Note previews the 1984 Representative Tax System (RTS) estimates of state-local fiscal capacity and tax effort. . . . The Intergovernmental Focus department spotlights the Texas ACIR. . . . ACIR News highlights recent Commission activities. . . . And the And Briefly: Books section describes some new reports of intergovernmental interest and includes an errata page reprint for the 1985-86 edition of *Significant Features*.

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# ACIR News

## Mayor Martinez Resigns Tampa/ACIR Posts

Bob Martinez has resigned as mayor of Tampa (FL) to devote full time to his gubernatorial campaign. As one of four city representatives, he has been a member of ACIR since 1984.

A replacement, nominated by the National League of Cities and the U.S. Conference of Mayors, will be named by the White House.

## ACIR Members Named Advisors To Infrastructure Council

North Dakota Senator David Nething and Charleston Mayor Joseph Riley, Jr. have been named to a special advisory panel of the National Council on Public Works Improvement. The five-member Council was created by the Congress as part of the *Public Works Improvement Act of 1984* to assess the state of the nation's infrastructure.

The Council and its advisory group will address a number of policy areas including a definition and assessment of needs; maintenance and renewal programs; capital management, including planning, priority setting, accounting and resource allocation; sources of funding and financing methods; the relationship of infrastructure to economic development and international competitiveness; and intergovernmental relations and responsibilities.

During the next two years, the Council will sponsor a series of nationwide public forums, hearings and conferences. The first of three major reports will be submitted to the President and the Congress in September.

## State/National ACIR Partnership Strengthened

As the interest in establishing state ACIRs and similar agencies has grown, so have the partnerships and network grown between and among the state panels and the national ACIR. With the addition of statutorily-based commissions in Louisiana and Oklahoma this year, 25 states now have an intergovernmental counterpart agency, 17 of which are patterned after the national ACIR model. A number of states have a state ACIR proposal under consideration or are seeking ways to restructure or otherwise strengthen their existing organizations.

Several steps have been taken to develop stronger working relationships with the state panels. For example, a national conference of state ACIRs has been held in conjunction with the Commission's spring meeting for the past four years, and the "Intergovernmental Focus" feature of *Intergovernmental Perspective* now highlights the work of one of the state agencies as a regular feature.

Earlier this year, the Commissin unanimously approved several other actions to broaden the state network and develop even stronger ties, including:

- continue staff efforts to promote the creation of new ACIRs and to strengthen existing agencies;
- explore the feasibility of sharing data, technical and other resources;
- identify specific areas where the states and the national ACIR might undertake joint research and information projects and publishing activities;
- work with other organizations, such as the State-Local Task Force of the National Conference of State Legislatures, which are working to improve state-local relations; and
- authorize staff to pursue outside funding opportunities to support the expanding state ACIR network.

The Commission also has authorized the publication of an information report based on the proceedings of the tort reform and liability insurance panel discussions at the spring state ACIRs conference (that will be available in September), and the first joint information project on the topic of state mandates. The state mandates report will be presented to the Commission at its December meeting.

# CITY AND COUNTY DATA

## NEW DISKETTES AVAILABLE

# GOVERNMENT FINANCE DATA FOR INDIVIDUAL CITIES AND COUNTIES

Last Fall, ACIR offered state-by-state government finance data on microcomputer diskettes. Now, government finance data for individual CITIES and COUNTIES are available on DISKETTES for all cities (and northeast towns) over 25,000, all counties over 50,000, and selected counties between 25,000 and 50,000 population. All data are for fiscal year 1984.

Each diskette contains data for population, 62 types of general revenue, 30 types of general expenditures, four categories of government debt, 14 revenue and expenditure categories of locally operated government utilities, and seven categories of local retirement system finances. All data are drawn from the Bureau of the Census' annual governmental finance series.

The diskettes will work with any microcomputer that is compatible with an IBM-PC and has a minimum of 384 RAM. Although primarily designed for use with LOTUS 1-2-3 and Symphony software, users of other spreadsheet programs which have a "translate" utility also will be able to use the diskettes.

The CITY AND COUNTY diskettes will be of considerable use to state and local government staffs, academics, public finance analysts, and others who wish to make intrastate and interstate comparisons of local finances, or who want ready access to the annual Census government finance data. In addition, the release of version 2.0 of LOTUS 1-2-3 will enable users to access the Census government finance data for multivariate statistical analysis.

Because of the large amount of data contained in the city and county series, diskettes are available on a regional basis and may be purchased individually or as a complete 12-region set.

TO ORDER, SIMPLY COMPLETE THE FORM BELOW, INCLUDE YOUR CHECK OR MONEY ORDER PAYABLE TO "ACIR", AND SEND TO: ACIR Publications, 1111-20th Street, N.W., Washington, D.C. 20575. ALL ORDERS MUST BE PREPAID. Questions about the content or operation of the ACIR diskettes should be directed to Michael Lawson at (202) 653-5536.

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|---|---|---|
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# Spotlight on the Texas ACIR

**Jay Stanford**
**Executive Director**
**Texas ACIR**

In January 1986, the Texas Advisory Commission on Intergovernmental Relations (ACIR) began its fifteenth year of service to the state, local governments, and citizens of Texas. During this period, the Commission has undertaken and completed numerous studies and other projects in response to needs identified by public officials. Much of the work has resulted in practical information for local and state entities, but also a sizable number of projects have had direct implications for the state legislative process.

The Texas ACIR was established by statute in 1971. The law was enacted in response to a recommendation by a blue ribbon commission that a state ACIR, based on the national model, should be created to provide continuing evaluation of the state's intergovernmental responsibilities.

Membership of the Texas ACIR reflects the different levels of government in the state. Most of the members are appointed by the governor, and include representatives of cities, counties, school districts, federal agencies, and special districts, as well as private citizens. Members of the legislature are appointed by the Lieutenant Governor and the Speaker of the House of Representatives. Both of these officers also serve as *ex officio* members of the Commission.

Experience and perspectives brought by the members to their service on the Commission have been the most important ingredients contributing to its success. Often, the local government representatives are also active in their statewide associations, and this provides critical input regarding (1) the selection of problems to be addressed and (2) the practicality of alternative solutions that may be developed through the Commission's studies. Similarly, legislative members often include chairmen or members of committees in both the House of Representatives and the Senate which are concerned with intergovernmental affairs and city or county governments.

Texas ACIR members serve six-year overlapping terms, and continuity has contributed to the stability and consistency of the Commission's work over the years. "Charter" members who have served on the Commission since its inception include the current chairman, Fred N. Pfeiffer, General Manager of the San Antonio River Authority, and Jim Dannenbaum, a citizen member from Houston.

## Projects

The Commission's work program has been broad and varied, not only tackling state and federal issues, but also addressing the problems of the several thousand local government entities. In Texas, there are 254 counties, 1,100 municipalities, over 1,000 school districts, and nearly 2,000 other special districts and regional governmental entities.

In the aggregate, Texas local governments are responsible for a higher percentage of total state-local revenues and expenditures than their counterparts in most other states, and their share of financial responsibility is still growing. Many of the Commission's projects have been concerned with local government fiscal issues—such as the impact of actual or proposed changes in the federal grant structure; revenue and expenditure needs; grant administration; and management strategies such as cost reductions, investment of idle funds, reliance on user charges, and risk management.

Commission projects usually are undertaken at the request of the local government associations, the governor's office, legislative committees, or other state agencies. Most of the agency's budget is obtained through grants and contracts with other entities. Therefore, for some projects, the Commission serves as a "consultant" by conducting research for the requesting agency. Such projects are related to the main focus of Commission research, however, and rely on experience gained through previous undertakings.

Informational projects have included a number of "handbooks" for local officials such as the *Guide to Texas Laws for County Officials*, now in its third edition. The Commission also has developed more specialized manuals and recommendations for administration in areas such as local law enforcement. A recent initiative has been the development of a "productivity consortium" composed of managers and productivity specialists from major cities and counties with participation by federal, state and private entities as well.

## Data Center

The common denominators for state and local government planning, as well as decision-making by private industry, are population and economic data. For the past two years, the Texas ACIR also has served as the State Data Center. Data centers have been established in all but one or two of the states. They provide liaison with the U.S.

Bureau of the Census on dissemination of census reports and computer tapes, planning for the 1990 census, and preparation of population estimates and projections.

The data "center" in Texas is actually a statewide network of computer facilities and local information contacts. It consists of the Texas ACIR as coordinator, three other "core" state agencies, eight universities serving as regional affiliates, and 25 local affiliates which are mostly councils of governments or regional planning commissions. Activities of the data center are now concentrated on (1) coordination of planning for the 1990 census, such as geographic boundary designations, and (2) development of a population estimates and projections program to provide statistics which can be used by the majority of the state and local planning entities. The population estimates and projections work is supported financially by a consortium from ten state agencies. Demographic research and computer support are being provided by Texas A&M.

### Special Issues

Recent federal legislation concerning disposal of radioactive waste is beginning to have a profound impact on Texas and a number of other states. Last May, sites in Texas and two other states were officially designated by the federal government as potential locations for a high-level nuclear waste repository. The proposed high-level repository will store used nuclear reactor fuel rods and other materials that will remain "hot" for over 10,000 years. This site selection process is being carried out by the U.S. Department of Energy (DOE) under conditions set forth in the *Nuclear Waste Policy Act of 1982* (NWPA). Texas is one of the states under consideration in the "first round" selection process. There also will be a "second round" selection that will involve potential sites in a number of other states during the next several years.

DOE began studying potential sites in Texas in 1976. Since that time, the state has developed an active program of monitoring and data gathering to ensure that DOE environmental assessments, socioeconomic analyses, and related studies are conducted accurately and reflect the requirements of the *Nuclear Waste Policy Act*. The Texas ACIR is responsible for planning and management of the state's social, economic, demographic and fiscal research studies related to the proposed repository site. The Governor's Office of Nuclear Waste Programs is responsible for the entire state effort in response to the federal selection process.

Texas and most other states are experiencing similar problems in relation to low-level radioactive waste disposal. "Low-level" radioactive waste consists primarily of common materials that have been contaminated by small doses of radiation, including paper trash, clothing, tools and glassware. Low-level waste, produced by university research facilities, hospitals, nuclear power plants, and industry, becomes relatively harmless after a few decades.

The federal *Low-Level Radioactive Waste Policy Act* requires each state to provide for disposal of its own low-level waste by itself or in cooperation with other states. Under 1985 amendments to the Act, the three states now receiving low-level waste are no longer re-

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Hugh Parmer, State Senator, Fort Worth
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(1 vacancy)

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Gib Lewis, Speaker of the House of Representatives, Fort Worth

quired to do so after 1992 (South Carolina, Nevada and Washington). Most states have formed multistate compacts to develop a joint disposal facility to handle their own wastes after that time.

Texas elected not to participate in a compact and has created a state agency with the sole responsibility of locating and developing a low-level site within its boundaries. The Texas ACIR is assisting the lead state agency with research on community impacts, potential mitigation and compensation measures, local government attitudes, and implementation of an impact assistance program.

### Other Areas of Recent or Current Interest

In addition to the continuing responsibilities for the State Data Center and the studies on radioactive waste issues, the Texas ACIR currently is involved in a number of short term studies and projects. Examples that follow include information and policy-oriented projects. Several of the activities are associated with interim studies directed by the 1985 legislative session.

- **9-1-1 Emergency Telephone Service.** Originally explored by the Commission in a 1979 study, local 9-1-1 systems have increased rapidly in Texas, partly as a result of recent local-option legislation. The executive director chairs an interim legislative study on the feasibility of implementing 9-1-1 on a statewide basis. A report will be presented to the 1986 legislature.

- **Management and Productivity.** Commission staff have assisted with an interim legislative committee on state agency management services and have consulted with leaders of a new employee incentive commission.

- **Insurance/Risk Management.** Following up on previous research conducted on tort liability and insurance issues, the Commission has just completed a risk management handbook for police departments. The manual identifies loss experience, areas of exposure, and potential steps for improvement. Further research regarding risk management and insurance pooling by political subdivisions is likely in the months ahead.

- **Data Sources for Business/Industry.** The staff is compiling a sourcebook on business and economic data maintained by state agencies. The data sources will assist planners and economic development specialists.

- **Indigent Health Care Financing.** In 1980, the Commission researched and prepared information and alternatives regarding indigent health care problems. A comprehensive study, conducted by a special legislative task force, resulted in major changes in state law last year. The Texas ACIR provided substantial staff assistance to the task force and continues to monitor implementation of the new legislation, with a view toward possible follow-up activities.

### Method of Operation

Over the years, Texas ACIR research and information projects have been practically oriented. The Commission has striven for objectivity and independence in its approach, while trying to be as responsive as possible to research priorities identified by local officials, executive and legislative leaders, and representatives of local government associations.

Texas ACIR projects vary from year-to-year in response to different problems created by economic, demographic and technological change. There are recurring themes in the Commission's work, however, which relate to the fundamental principles of governmental structure, finance and administration. The Commission also devotes continuing efforts toward providing basic information for planning and decision-making for all levels of government in the state.

Members of the Commission meet every two months to review the full-range of Commission projects, make decisions regarding future undertakings, and guide the staff in agency financial and administrative management. Members and staff have as a primary goal to be able to respond to the challenges presented by the complex relationships among governments in an environment of rapid economic and demographic change.


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# Point

# Turnbacks: A Promising Approach

**Robert B. Hawkins, Jr.**

**Because a recurrent theme in American political history has been the great emphasis placed on political decentralization as an enduring value, ACIR has recommended turnbacks—simultaneous repeal of federal grant-in-aid programs to state and local governments and relinquishment of tax bases—as a promising approach to achieving increased accountability in our federal system. While some obviously localistic programs have previously been folded into block grants, there remains a plethora of categorical grants best financed and administered at the state and local levels.**

Over the past 30 years, federal grants-in-aid have grown exorbitantly, both in number and in aggregate dollars. Observers of the intergovernmental system, including ACIR, repeatedly stated that the increasing fiscal and political power of the national government relative to its state and local partners brought the federal system into imbalance. Because of the intricate accumulation of program constraints and requirements, public officials' responsiveness and accountability to the citizenry frequently became impeded. This often distorted the public choices made by the various units of governments administering intergovernmental programs.

More recently, the pressure of huge federal budget deficits engendered cutbacks in grant funding, and this has led to a kind of de facto, disorganized decentralization wherein state and local governments are now financing some program responsibilities formerly funded by Washington. Turnbacks represent a path toward an orderly sorting out of responsibilities: the federal government's withdrawal from programs would be accomplished concurrent with a certainty of funding resources.

### Decongesting the System

In other reports, the Commission has characterized the present federal system in such terms as "congested, overloaded, intrusive, inefficient, and unaccountable." This has led to an unmanageable national political agenda, promoted undue federal interference in the operations of state and local governments, and frequently produced incongruences between citizen preferences and the goods and services provided by their governments. The cumulative effect of financial reliance on the national government, and the many conditions and requirements attached to the federal aid, has been to erode the authority of state and local officials. Because most grant-in-aid programs lack flexibility in design and implementation, the most desirable characteristics of a federal system—innovation and diversity—have been seriously retarded.

The Commission believes that the federal government should return many responsibilities more appropriately handled by states and localities or private institutions, along with the revenue sources to pay for them. Such an initiative would provide a means to augment permanently the tax bases of state and local governments, and improve the predictability of state and local revenues. Along with economic efficiency, turnbacks also would enhance political accountability by giving citizens greater access to elected and appointed officials making public choices.

As the first step in proposing turnbacks, the Com-

mission established a test of vital national interest—i.e., only when a program meets certain criteria is national government action justified. This test is detailed in the accompanying box. Applying it to the more than 400 existing federal grants-in-aid, the Commission identified a "candidate list" of 177 programs that could be returned to state or local control. These were in the area of arts and humanities, community development, criminal justice, economic development, economic opportunity, elementary and secondary education, employment and training, food and nutrition, highways and public transportation, libraries, medical assistance, natural resources conservation and development, occupational safety and health, vocational education, volunteer services, and water pollution control.

### The Revenue Return

The approach selected by the Commission for returning revenue sources is for the federal government to relinquish all or part of a tax base it currently uses. Chief among those that could be returned to the states (and in some cases directly to localities) are the federal excise taxes on motor fuels, cigarettes, telephones and alcohol. The Commission also noted that the personal income tax is probably the best tax to return in part to state and local governments in seeking to achieve greater political decentralization. Unfortunately, revenue returns by cutting federal income taxation—in light of the tax reform effort—is politically the most difficult to achieve.

While the Commission did not propose any specific legislation, the report accompanying the recommendation (*Devolving Federal Program Responsibilities and Revenue Sources to State and Local Governments*, A-104) includes five possible ways for the federal government to give serious consideration to turnbacks. Each package would return federal excise taxes to the states while the federal government recedes from a variety of programs. The five packages involve $10 billion, $17 billion, $18 billion, $21 billion, and $22 billion in programmatic authority, and would replace from 84% to 98% of the revenues with excise taxes. In addition, the recommendation directed the ACIR staff to develop alternative packages at the request of interested parties.

### Principles and Pragmatism

The Commission further recommended that any turnback package be based on the following principles:

- The legislation should provide for an adequate transition period to allow state and local governments to adjust to the new environment of increased political decentralization.
- It should include an adequate pass-through of state funds to local governments during the transition period.
- There should be a mechanism during the transition period to facilitate any state legislative or constitutional changes necessary to adjust the political and fiscal relationship between states and their local governments.

There is an important pragmatic rationale for examining turnbacks at this time. The fiscal reality of current intergovernmental relations is that the federal grant-in-aid system has been under constant budgetary pressure since the mid-70s, and that federal grants will undoubtedly be subject to increased pressures for the foreseeable future. Since 1978, overall spending by states and localities, in constant dollars, has been stable. However, the relative importance of sources of spending has changed dramatically as state and local revenues from their own levies have increased at the same time that federal assistance has declined. In 1978, intergovernmental grants were equal to 36.7% of state and local "own-source" spending; by 1984, that figure declined to 26.9%.

To diminish deficits, it is certain that the Congress will continue to seek spending reductions from that portion of the domestic budget that finances grants-in-aid to state and local governments. Turnbacks offer a way to help meet the mandate for deficit reduction in an efficient and equitable manner.

In a sense, turnbacks might be considered a successor to revenue sharing. While that position may chagrin those who have long supported the revenue sharing concept (including ACIR), the political reality is that the program will almost surely be terminated. Because revenue sharing was originally to be the major decentralization mechanism in the federal system, its demise necessitates a replacement. Turnbacks, which involve both programmatic and tax source returns to states and localities, can act not only as a replacement for revenue sharing, but would represent a true return of authority. For as long as Washington controls the purse strings on the revenues of other units of government, states and localities can never be certain of levels of funding; nor can they be truly self-governing.

Equally as important as fiscal concerns is the restoration of sound federalism principles inherent in the turnback concept. Writing in his autobiography at the age of 77, Thomas Jefferson said: "Were not this great country already divided into states, that division must be made, that each might do for itself what concerns itself directly, and what it can so much better do than a distant authority . . . Were we directed from Washington when to sow, and when to reap, we should soon want bread." Turnbacks endeavor to restore the Jeffersonian virtues of diversity and decentralization that have been seriously eroded over the past two or three decades.

As the number and financial magnitude of federal grants multiplied during the 1960s and 1970s, so did the federal mandates attached to them. Almost every grant became a vehicle for meeting national environmental, civil rights, handicapped access, relocation, historical preservation, citizen participation, and planning standards. In addition, the federal government mandated detailed standards for budgeting, reporting, auditing and other administrative standards. These often confrontational national policies generated massive amounts of new litigation, and because of the federal dollars involved most of the cases upheld federal dominance in these matters. The federal courts not only acceded to the judgement of the Congress in most cases, but even went beyond the vagueness of laws to supply concrete operational interpretations

and direct administrative remedies.

Taken together, the activities of the national government have significantly weakened state and local governments' political and fiscal accountability to their citizens by driving a wedge between taxing and spending choices. The will of local majorities has been broadly and unjustifiably thwarted. Washington's activism also has unnecessarily burdened other units of government with intrusive requirements and onerous demands and procedures. This has had the effect of circumscribing the authority of states and localities to the point of hampering effective governance.

The Commission's turnback recommendation contemplates the return of three kinds of responsibilities to the state and local levels: the responsibility of deciding whether and in what amounts to provide certain goods and services which currently are federally supported; the responsibility of deciding how to provide them; and the responsibility for raising the revenue to finance any increase in state and local government activity necessitated by these state and local decisions. Citizens' choices on whether a given service is better assumed by the public sector, as opposed to the private sector or by volunteers, can better be articulated through the state and local political process than by Washington.

At its core, federalism concerns itself with the constitutional design of multilevel government—what James Madison called a "compound republic." Indeed, a compound society such as the United States cannot be governed without a system to accommodate diversity. While some might view decentralization as fostering disparity—a diminishing of national community—those of us who seek to return authority to states and localities see it as fostering harmony among a diverse people. Surely, we are one nation, but it is a nation of unique parts. Turnbacks offer a way to accommodate differing social and political climates across a vast land, and for a diverse people to demand those government services they want and need.

*Robert B. Hawkins, Jr. is the Chairman of ACIR. He is President and Chief Executive Officer of the Institute for Contemporary Studies in San Francisco.*

# THE TEST OF VITAL NATIONAL INTEREST: NECESSARY AND SUFFICIENT CONDITIONS FOR ACTIVITY BY THE NATIONAL GOVERNMENT

(Satisfaction of each of the following conditions is required to justify national government activity. A condition is satisfied only if the appropriate criteria are met under each.)

**Condition 1 (Constitutionality)** The activity is, under current interpretations of the Constitution, within the constitutional authority of the national government.

(Condition 1 is satisfied if the following criterion is met.)

Criterion 1.1: There exists no provision in the U.S. Constitution that specifically prohibits the national government from undertaking the activity.

**Condition 2 (Warrantability)** The activity is warranted by the presence of a problem of national scope, or significantly large regional scope, that requires for its solution some measure of national control over, stimulation of, or coordination among subnational governments, private institutions, or citizens.

(Condition 2 is satisfied if at least one of the following criteria is met.)

Criterion 2.1: In the absence of activity by the national government, activities of subnational governments, private institutions or citizens would produce significant interstate externalities (i.e., spillover effects).

Criterion 2.2: Absent activity by the national government, certain goods and services at national scale would be substantially underproduced because of their "public good" properties or because such goods and services are subject to declining marginal costs.

Criterion 2.3: Absent activity by the national government, the activities of subnational governments, private institutions or citizens would weaken the operations of national markets.

Criterion 2.4: Absent activity by the national government, subnational governments would violate the constitutional rights of individuals.

Criterion 2.5: Absent activity by the national government, there would be significant horizontal inequities among residents of different states; i.e., in states with relatively low fiscal capacity, taxpayers would have to bear inordinately high tax burdens to finance state-local services deemed essential.

**Condition 3 (Economic and Programmatic Efficiency)** The benefits (both economic and noneconomic) derived from activity by the national government exceed the activity's costs—not only the budgetary cost to government but also all other costs likely to result to society as a whole. Further, it can be established that action by the national government designed to correct the problem will represent, in fact, the most efficient available solution, including no governmental action.

(Condition 3 is satisfied only if each of the following criteria is met.)

Criterion 3.1: No workable alternative to national activity is at least as efficient.

Criterion 3.2: The overall national benefits warranted by Condition 2 must exceed the overall national costs of carrying out the activity.

Criterion 3.3: Other than specifically warranted by Condition 2, the activity of the national government does not artificially induce increased taxing and spending by subnational governments, private institutions, or citizens. A polity's capacity to achieve fiscal discipline is not weakened.

Criterion 3.4: Without good reason, the activity of the national government does not make uncertain the financial situations or other circumstances of subnational governments, private institutions or citizens.

Criterion 3.5: An activity of the national government does not burden subnational governments with intrusive requirements and onerous demands or procedures. The authority of states and localities is not so circumscribed as to hamper effective governance and responsiveness to their citizens.

Criterion 3.6: The activity by the national government does not significantly weaken any government's political and fiscal accountability to its citizens by driving a wedge between taxing and spending choices.

Criterion 3.7: An activity of the national government does not work broadly and unjustifiably to thwart the will of local majorities.

# Counterpoint

# Turnbacks: A Misguided Effort

**Joseph P. Riley, Jr.**

**In one year, we will celebrate the 200th anniversary of our Constitution, our commitment to a federal system and the rejection of a confederation. Ironically, the proposed use of turnbacks to achieve increased political decentralization flouts the principles we are preparing to celebrate. The revenue turnback proposal is a philosophically driven and misguided effort. If its directives were enacted by the Congress, our cities and their citizens would incur substantial harm.**

This proposal personifies the sin of excess, a hallmark of the far left and the far right. Excess, or at least the fear of excess, provoked a national re-evaluation of the federal system. The rapid growth and escalation of categorical federal programs in the 1950s, 1960s and early 1970s led to allegations that the federal system was congested and had caused a loss of local autonomy. The criticism that a national response to problems might have been carried to excess in some areas was fair. The result was a re-evaluation of the system, and the pendulum began swinging back in the other direction. This swing led to a substantial decongestion in the federal system.

Two important examples illustrate measures adopted to decongest the system. The General Revenue Sharing program was in part a response to this effort. The program is the diametric opposite of a categorical grant; there is little red tape; it has complete respect for local autonomy and is allocated at the "level of government closest to the people." It is ironic that the leading proponent of the decongestion of the federal system is recommending the abolition of General Revenue Sharing, however, much to the fiscal harm of local governments and their citizens.

The Community Development Block Grant (CDBG) program was another response to the need to decongest the federal system. CDBG replaced many categorical federal programs and replaced them with one block grant where, under general federal guidelines, local governments have the autonomy to allocate the money where the local level deems necessary. This successful program has spirited the revitalization of hundreds of cities and communities across this country; yet it is another program slated to be dissolved under this proposal, causing more harm to our cities.

The growth of the federal government in relation to programs affecting state and local governments started to reverse in the mid-1970s. By 1978, dollars allocated to state and local governments had peaked. Since 1978, there has been a substantial reduction of programs and funding. Federal funds for urban-related programs have been reduced substantially. For most cities, we have had a near-fatal dose of antihistamine. We can afford no more decongestion.

We have a decentralized government by any reasonable standard. In my city of Charleston, this year's budget required a property tax increase, in part because of a reduction in General Revenue Sharing funds. If General Revenue Sharing is completely abolished next year, we will have another and far more substantial property tax increase.

Most cities in our country, Charleston included, suffer from a relatively insufficient tax base and very limited sources of revenue, tightly restricted by state constitutions and state statutes. We do not feel congested by the federal system; we pass our budgets and ordinances without supervision by federal or state bureaucrats. At City Council meetings, the talk is not of decongestion but of a lack of resources.

### Excessive Decentralization

If the proliferation of categorical grants-in-aid during the 1960s and 1970s resulted in excessive cen-

tralization of government, then the sin of excessive decentralization is likewise committed in this Commission recommendation. It would result in a dereliction of responsibilities by Washington, particularly toward the nation's cities.

This turnback effort is not primarily an effort to decongest; it expresses the philosophical imperative of some to have our national government wash its hands of any concern for local needs and problems. It is the philosophy that "this is not our problem—it's your problem in the cities." Local governments are viewed as not only autonomous but also just as one of the many Third World countries. This turnback philosophy believes that public transportation is not our problem as a nation—it's your problem in the city. The hungry and the homeless, the mentally ill, the terrible cycle of poverty and unemployment in the central cities are not problems of the United States, but localized inconveniences to be borne solely by the states and cities. To be sure, the problems of public transportation, economic development, slums, poverty and homelessness are local problems and can be solved only when there is a determined and aggressive partnership driven at the local level. But these problems can never be solved if our national government does not share its part of the responsibility of that partnership.

**National Issues—National Responses**

There is no need to apologize for this last generation's national efforts to address issues national in scope by assisting state and local entities. This effort, in historical perspective, has made our country greater. The mid-course corrections required by such a complex undertaking are in place. Now the entire federal-city partnership is being threatened by a philosophy that would inject a fatal dose of antihistamine into a system of government where there is scant evidence that congestion even exists.

Under the turnback philosophy, one would argue that there would never have been a National Endowment for the Arts or a National Endowment for the Humanities. That would have been most unfortunate for our country, because these two agencies have given national leadership, encouragement and modest funding to thousands of artistic endeavors throughout our country that have made this a richer nation. Under the turnback philosophy, there would never have been an Urban Mass Transportation Administration that helped to develop a national consensus on the need to "decongest" our central cities and make our urban areas more livable.

Urban Development Action Grants are not pervasive; they are targeted to our most distressed central cities. Pollution control grants are not intrusive; they help preserve our national environment. Community Development Block Grants are not unmanageable; the program replaced scores of categorical programs and helped revitalize hundreds of cities across our country. General Revenue Sharing is not inefficient; it has complete respect for local autonomy and is allocated at the level of government closest to the people. And these programs—along with scores of others—are costly and unaccountable only to the extent that the Congress imposes excessive restrictions. What is needed is not a turnback, but more flexibility in existing programs.

I ask the proponents of a large-scale turnback program to climb down from their ivory towers and come to my city. I can show them how those national efforts, carried out by an autonomous, uncongested, local, closest-to-the-people government have immeasurably improved my city and all of its people—who are, by the way, American citizens, part of this nation and part of the federal government.

They are not part of a confederation. The confederation ended almost 200 years ago. They are part of a national government and have reason to expect that their national government, as well as their state and local governments, will accept a responsibility to address their needs, whatever they are, wherever they are found.

The rationale for this ACIR turnback recommendation relies on unsubstantiated generalizations which few state and local elected officials and civil servants would endorse.

A major federal turnback effort would do substantial harm to my city and most cities of our country. It would end programs that have been good and successful and would create, at best, an uncertain future. There is little chance that most of the initiative sponsored by these programs would be kept. Certainly, the cold-hearted suggestion to give a tobacco excise tax to state governments, and the other turnback taxes, present no long-term financial hopes. Further, there are state constitutional and statutory barriers to any legitimate pass-through of this taxing authority to local governments. In terms of turning back revenue to localities, many local governmental units do not have the authority—and possibly not the capacity—to pick up the funding of turned-back programs, even though such programs are needed.

The claim that turnbacks are efficient is specious. There are many national initiatives that cannot be divided by fifty in terms of the states or by a thousand or more in terms of cities. The turnback proposal supports a theory that we would have fifty Institutes of Museum Services, or perhaps a thousand. One national Institute of Museum Services can help set some national goals and thoughtfully allocate money where it can be wisely and prudently used. A plethora of Institutes of Museum Services would consume the modest amount of available money just in terms of administrative and bureaucratic expenses. The same can be said of many federal programs that can be run far more efficiently by a small national staff than by fifty state staffs or a thousand local staffs. There are many more examples of this inconsistency in the turnback philosophy.

**Deficit Reduction**

Turnback proponents cite the need to reduce the federal deficit. Their implication that federal grant-in-aid programs continue to grow is erroneous. It is important to remember that in the last six years when the federal deficit has shot up from $70 billion to more than $200 billion, urban programs have been severely reduced. There was a definite peaking in 1978 of dollars allocated to state and local governments. Between 1980 and 1985, total federal expenditures increased by 23.3%, with defense increasing by 33.9% and interest on the debt increasing 86%, while federal grants to

state and local governments decreased. Local governments have already taken more than their fair share of federal budget cuts. It is unrealistic and unfair, if not dishonest, to argue or even to hint that federal urban programs caused the explosion in the size of the national deficit.

The linking of turnbacks with deficit reduction carries scant cogency because our country's basic deficit problem is caused by a failure of political will to deal at the federal level with its root causes and a lack of fiscal discipline in defense spending. This has precious little to do with intergovernmental relations and turnbacks.

The recommendation fails to recognize the constraints within the Congressional process which severely limit the use of turnbacks: the overlapping jurisdiction of committees; the competing interest groups and their reluctance to see their programs changed or given to another level of government; and the reluctance of elected officials, having enacted taxes and being criticized for it, to hand the revenue over to another jurisdiction.

In my opinion, this federal turnback proposal belongs in the files of the ACIR. This proposal swings far too sharply to the right.

Our country will always seek to provide national initiatives—and we should. A given President and Congress will, as they should, look out across this great country, see problems that are important—whether they are housing, economic development, mass transit, encouragement of the arts, poverty, hunger, AIDS or cancer—and they will seek to develop a national response. Because of our experiences in the 1950s, 1960s and 1970s, our country will be less likely to develop a heavy-handed categorical approach and will be more likely to involve the states and localities to every extent possible. Washington will be far more alert to the excesses of a national response, but not oblivious to national need.

The error of this massive turnback program is that it forgets that we are a nation and we should be proud of, not apologetic for, being so. I believe that in years to come this ACIR report will be considered a benchmark—the benchmark of when the pendulum had swung too far to the right.

*Joseph P. Riley, Jr. is Mayor of Charleston, South Carolina, and has served as a member of ACIR since 1981. He currently is President of the U.S. Conference of Mayors.*

A Special Report

# The Impact of the Farm Recession on Local Governments

Michael Lawson

**The agricultural recession has been widely reported. Although much has been written about its effects on individual farmers and their communities, little attention has been paid to its effects on the financial health of local governments. The significance of the public sector dimensions of the problem recently were described by Senator David Durenberger:**

> My experience in Minnesota and throughout the country strongly suggests that the current agricultural recession, and its effects on the broader rural economy, are beginning to affect—and will increasingly hamper—the abilities of local governments in rural areas to raise sufficient revenues to finance basic public services like education, public safety and transportation.

In December 1985, Senator Durenberger and other members of the Advisory Commission on Intergovernmental Relations requested the staff to undertake a quick "reconnaissance study" that could provide a basis for a more detailed analysis by the newly-formed Commission on Agricultural Policy. The ACIR staff was directed to examine intergovernmental issues and analyze readily available sources of data. In addition, the staff was instructed to identify issues which the new commission might wish to examine and data sources which might be relevant to their work.

This article summarizes an ACIR staff information report that focused on a sample of ten farm-dependent states in the North Central, Plains and South regions. However, before the fiscal health of localities in the sample states is discussed, several general observations emerged from the study which are applicable to the analysis of fiscal health of local governments in most states. These general observations are:

- Because most of the own-source revenue of local governments typically is raised from property taxes, the governments in most communities are protected from dramatic fluctuations in revenue—and, therefore, dramatic changes in service levels—in the short run.
- This "stickiness" in property tax revenue results from the way property taxes are generally administered: significant lags in assessments fail to reflect rapid declines (or increases) in market values of property. Furthermore, farm land often is assessed at its "use value" rather than at market value; in recent years, the use value of farm land has not changed as dramatically as has market value.
- Over a period of several years, decreases in property tax assessments certainly will place additional stress on local governments. In the short run, changes in the value of property typically will have only a modest impact on the ability of local governments to maintain current levels of own-source revenue.
- In sharp contrast to local experience, states typically raise most of their revenue from sales and income taxes—taxes that are quite responsive to changes in economic conditions.
- The more dependent local governments are on their state governments for financial assistance, the greater their exposure to the revenue fluctuations of the state governments.
- Reductions in state aid will not affect all local public services to the same extent. Because local governments are most reliant on states for education, roads, health services, and hospitals, these

local services are more vulnerable to cuts than are others—e.g., police and fire protection.

### Defining Fiscal Stress

Fiscal stress is certainly an arguable concept; it can be defined in a variety of ways. Viewed in absolute terms, fiscal stress of an individual government would be apparent if that government were unable to provide an adequate level and quality of public services at a reasonable level of taxation. However, this definition raises further questions: what are adequate levels of services or reasonable levels of taxation? Viewed in relative terms, a fiscally-stressed government would be unable to provide services that are roughly equivalent to services available to citizens in other jurisdictions—at roughly equivalent levels of taxation.

Yet, relative stress can be viewed in a more pragmatic way—fiscal stress is apparent when a rather sudden decline in revenue forces the jurisdiction to cut its expenditure levels or increase its tax rates simply to maintain existing levels of service. This view of fiscal stress was adopted in the study.

### Methodology

In sorting through many diverse sources of information about the condition of the ten sample states (selected in consultation with the staff of the Senate Subcommittee on Intergovernmental Relations), it became apparent that several indicators of present or potential fiscal stress could be pulled together for each of the states, for their local governments in general, and for the local governments in the most farm-dependent counties in those states. While recognizing that the best indicators of fiscal stress would be significant decreases in the levels of local services, such indicators are not available. Most of the indicators used are revenue data, which serve as crude proxies for the potential for cuts in services.

### Selection of the Sample States

Nationwide, there were 702 counties that derived 20% or more of their total labor and proprietor income from farming/ranching during 1975-79 (see *Map A*). As the map shows, these counties are largely in the North Central and Plains states, with others scattered in the Northwest and throughout the South. Of the ten states chosen for this preliminary analysis, seven are in the mid-section of the nation, while the other three are in the southern region.

The farm-dependent counties in the sample North Central and Plains states (Iowa, Kansas, Minnesota, Missouri, Montana, Nebraska and North Dakota) were chosen because of their high degree of dependence on grain farming—among the hardest hit sector of the agricultural economy. The southern states were added to the sample to provide some comparison with other types of farming and different traditions of state and local government.

Even these sample states and counties vary from one another considerably in their degree of farm-dependence. *Table 1* ranks the ten states on the basis of the percentage of all personal income in each state that comes from farms, ranging from almost 10% in North

**MAP A**
**702 FARMING-DEPENDENT COUNTIES**
20% or more of total labor and proprietor income was from production farming/ranching during 1975-79.

Source: Economic Research Service, U.S. Department of Agriculture.

**Table 1**
**Indicators of Fiscal Stress for 10 Selected State Governments**

| State [Ranked on the Basis of Farm Dependence] | (1) Percentage of all State Personal Income From Farms | (2) Percent Change in State Revenue 1984-85 | (3) Percent Change in State Revenue 1985 est. | (4) Energy & Mineral Rev. as a % of Own-Source Gen. Revenue | (5) State Budget Cuts Since FY86 Budget Adopted | (6) Changes in State Funding for Education Since 1986 Budget Adopted | (7) Fiscal Stress Apparent |
|---|---|---|---|---|---|---|---|
| U.S. Average | 1.43% | 9.1% | 4.9% | n.a. | 17 | n.a. | n.a. |
| North Dakota | 9.88 | 1.1 | −19.5 | 22.0 | X | Decreased | Yes |
| Iowa | 6.96 | 2.9 | 4.4 | 0.4 | X | Decreased | Yes |
| Nebraska | 6.88 | −2.7 | 7.9 | 1.5 | X | Decreased | Yes |
| Arkansas | 4.91 | 13.2 | 3.3 | 1.5 | X | Decreased | Yes |
| Kansas | 4.02 | 6.8 | 1.4 | 5.4 | | Increased | Yes |
| Georgia | 3.37 | 14.4 | 7.7 | 0.1 | | Increased | No |
| Minnesota | 3.34 | 3.0 | −4.3 | 1.3 | X | Increased | Yes |
| Mississippi | 3.28 | 4.1 | 7.7 | 5.3 | X | No Change | Yes |
| Missouri | 1.30 | 9.8 | 6.4 | 2.6 | | Increased | No |
| Montana | 0.91 | 9.8 | −4.2 | 21.1 | X | Decreased | Yes |

= Indicator of actual or potential fiscal stress.

Sources: Farm income data based on Bureau of Economic Analysis, *Survey of Current Business*, August 1985; percentage increase in state tax revenue for 1985 based on Census, *State Tax Revenue in 1985*, February 1986; percentage change in state general fund revenue in FY 86 and information on state aid to education based on telephone conversations with state officials, March 1986. All 1986 estimates made between November 1985 and March 1986. ACIR staff compilation and calculations.

Notes:

KS: Estimates made as of November 1986 and incorporate a drop in oil prices from $27/bbl. to $20/bbl. Because oil prices have fallen well below $20/bbl., the 1986 estimate is probably too high.

MN: There was a 10% surcharge on individual income tax still in effect for the first half of FY 85, making the 1986 decrease more pronounced than it otherwise would be.

NE: Estimates made as of February 1986 and assume an increase in the individual income tax from 19% to 20% of federal tax liability.

Dakota to less than 1% in Montana, against a national average of 1.43%. *Table 3* shows the proportion of counties in each state meeting the farm dependency criteria, ranging from 72% in North Dakota to 20% in Georgia.

### Indicators of State Fiscal Stress

Local finances are closely linked with state finances because local governments unable to raise sufficient revenues to provide essential services from their own revenue sources are likely to turn to their state governments for fiscal assistance. The extent to which states can assist their troubled governments depends on both the financial well-being of the state as a whole and on the institutional arrangements between state and local governments—e.g., state aid to local governments, the formulas on which those grants are based, and the historical pattern of state assistance to local governments. *Table 1* examines this second topic.

The states are arrayed in order of the importance of farm income as a percentege of all state personal income (column 1). The data in column 1 indicate the degree of exposure of the state government to financial problems experienced by many farmers and farm-related businesses. However, a high percentage of personal income derived from farming is not necessarily an indication of state fiscal stress. For example, a state that has a significant percentage of its personal income derived directly from farming also may have an even greater percentage of its personal income from economic sectors that are enjoying robust economic growth. Furthermore, it must be recognized that some farmers—particularly those carrying large high-interest debts—are affected more adversely than others by the current farm recession.

The data in columns 2 and 3 display the rate of growth in state revenues during the last two years;

they may be compared with the national average that is given at the top of the column. If state revenues do not keep pace with population growth, inflation and the traditional demand for public services, undoubtedly the fiscal stress of a state government will increase. The fact that a number of the selected states have rates of revenue growth well below the national average gives a strong indication that the revenue bases of these states were not growing at a rate necessary to continue full financing of many state and local programs. In fact, North Dakota, Nebraska and Montana have experienced actual reductions in state revenues without reductions in state tax rates. Among the states surveyed, only Minnesota enacted a reduction in state tax rates (after an earlier increase) and experienced a drop in collections.

The inclusion of data on energy and mineral revenue as a percentage of own-source general revenue (column 4) initially may seem incongruous with this attempt at identifying the fiscal stress in agriculturally-dependent states. However, several of the sample states—most notably North Dakota and Montana, but also Kansas and Mississippi—derive significant portions of their state revenues either directly from oil and energy industries in the form of severance taxes or royalty fees, or indirectly from the economic resources that energy industries provide in the state. With the recent dramatic drop in oil prices, governments in states with a high dependence on energy industries will be affected adversely. The problems caused by drops in state revenue due to falling energy prices will be particularly acute for states already affected by the agricultural recession.

Cuts in FY 1986 budgets made subsequent to their enactment (columns 5 and 6) present direct measures of the fiscal stress of the selected states. Note that of the 17 states nationwide which have enacted such cuts, seven are represented in the ten states selected for this study (column 5). Cuts in state aid to education (column 6) provide an even better measure of fiscal stress because education is generally considered to be the most popular state-local program—drawing large amounts of support from middle class taxpayers and various education interest groups. Typically, education is one of the last government functions to be cut in austere times.

Based on these data, it appears that only two of the states in the ten-state sample are not experiencing some degree of fiscal stress—Georgia and Missouri (*Table 1*, column 7). Based on the factors identified in columns 1-6, North Dakota and Montana are facing fiscal stress on two fronts. North Dakota not only has one of the highest percentages of state personal income derived from farming, but it also has one of the nation's highest percentages of state own-source revenue drawn from severance taxes and royalty fees. The overall budget cuts and the cuts in aid to education were forced by the precipitous drop in state revenues in FY 1986 as evidenced in column 3. While Montana's indicators read much the same as North Dakota's, its lesser dependence on agriculture makes its fiscal position slightly better than that of North Dakota.

According to the indicators, the states of Iowa, Nebraska, Arkansas, Kansas, Minnesota and Mississippi also exhibit some fiscal stress. All of these states have sluggish rates of growth in their state revenues, and all but Kansas have made cuts in their FY 1986 budgets.

### Indicators of Local Fiscal Stress

The fiscal condition of local governments in the ten sample states is set forth in *Table 2*. One key indicator of **existing** local fiscal stress is shown: the change in local revenue is shown both for own-source general revenue and for tax revenue. Four indicators of **potential** vulnerability to fiscal stress (dependence on the property tax, fiscal home rule, state aid dependence, and federal aid dependence) also are displayed. In addition, *Table 2* summarizes the indicators of fiscal conditions of local governments and repeats the summary findings on state fiscal distress in the ten sample states for the purposes of comparison.

This rating of local fiscal conditions is riskier than the rating of states, because the data do not go beyond 1984 and the farm situation has further deteriorated since that time. Nevertheless, this table can be interpreted in conjunction with the more recent data in *Table 1* to yield a general sense of current fiscal stress at the local level. The established relations between the fiscal affairs of the states and their localities usually do not change rapidly or dramatically.

*Table 2* shows that growth in local revenue during 1982-84 lagged behind the national average in six of the ten states, either in total own-source revenues or tax collections, or both. If that lag continues for a long time, it could mean either reduced services, higher tax rates, or increased dependence upon state or federal aid.

Local governments in North Dakota, Georgia and Missouri are more dependent than average on federal aid. This dependence makes them more vulnerable to cuts in federal aid—including the termination of general revenue sharing.

Local governments with a high degree of dependence on state aid—such as those in North Dakota, Arkansas, Minnesota and Mississippi—are vulnerable to reductions brought about by fiscal stress at the state level. Because the state governments in these states are exhibiting symptoms of fiscal stress, they may find it difficult to maintain or increase their current levels of aid to local government.

Greater than average dependence on the property tax shows up in *Table 2* for local governments in North Dakota, Iowa, Nebraska and Montana. This dependence on the property tax makes local governments in these states vulnerable to declines in property tax revenues caused by falling farm assessments.

Four states—North Dakota, Iowa, Nebraska and Montana—also provide less than average fiscal home rule authority to their cities or counties, or both. Absence of fiscal home rule restricts the ability of these jurisdictions to raise tax rates or tap additional revenue sources—particularly relevant for local governments with a high degree of dependence on a property tax base that is contracting. Lack of fiscal home rule also is a problem for cities in Minnesota, counties in Missouri, and both cities and counties in Mississippi.

The overall ratings indicate that local governments

**Table 2**
**Fiscal Profiles of Local Governments in Ten Selected States**

| Local Govts. in Selected States | Stress Indicators: Change In Local Revenues 1982-84[1] Own-Source Gen. Revenue | Change In Local Revenues 1982-84[1] Tax Revenue | Potentials for Increased Stress: Federal Aid as % of All Local General Revenue 1984[2] | State Aid Dependence: 1984 (% of General Revenue)[3] All Local | County Only | Muni. Only | School Only | Property Tax as % Own-Source Revenues 1984[4] | Fiscal Home Rule[5] City | Fiscal Home Rule[5] Co. | State Fiscal Stress Apparent[6] | Local Fiscal Stress Apparent |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| U.S. Avg. | 20.4% | 19.1% | 6.5% | 32.7 | 32.0 | 19.6 | 51.6 | 47.1% | 3.2 | 3.7 | n.a. | n.a. |
| North Dakota | 10.1% | 12.3% | 7.6% | 41.1 | 33.4 | 16.8 | 56.4 | 54.1% | 3.5 | 4.0 | YES | YES |
| Iowa | 11.4% | 12.9% | 5.2% | 33.2 | 23.0 | 14.2 | 50.4 | 61.1% | 4.5 | 4.5 | YES | YES |
| Nebraska | 17.0% | 16.0% | 4.6% | 20.6 | 18.1 | 13.7 | 28.0 | 52.4% | 3.5 | 5.0 | YES | YES |
| Arkansas | 17.1% | 22.4% | 6.5% | 38.5 | 17.2 | 14.6 | 60.5 | 37.7% | 3.0 | 3.0 | YES | NO |
| Kansas | 15.8% | 18.0% | 4.7% | 23.6 | 7.9 | 5.9 | 42.9 | 48.6% | 3.0 | 3.0 | YES | NO |
| Georgia | 22.1% | 22.5% | 8.1% | 25.8 | 12.5 | 4.5 | 58.7 | 35.1% | 3.0 | 3.0 | NO | NO |
| Minnesota | 24.9% | 38.9% | 5.0% | 39.0 | 46.0 | 19.9 | 55.1 | 47.5% | 4.0 | 3.0 | YES | NO |
| Mississippi | 25.2% | 21.0% | 5.5% | 41.3 | 16.5 | 25.1 | 70.3 | 36.4% | 4.0 | 4.0 | YES | NO |
| Missouri | 13.4% | 10.2% | 7.7% | 25.7 | 10.7 | 7.4 | 42.3 | 36.2% | 3.0 | 5.0 | NO | YES |
| Montana | 35.2% | 7.0% | 6.6% | 22.7 | 7.4 | 5.5 | 38.5 | 52.7% | 5.0 | 4.0 | YES | YES |

Actual or potential fiscal stress; see notes 1/ thru 6/ for interpretations.

1/ Local revenue growth of 16% or less indicates fiscal stress.

2/ The more dependent that local governments are on federal aid, the more likely they are to experience increased fiscal stress from federal aid cuts.

3/,6/ These indicators must be read together. The amount of future state aid depends on the degree of fiscal stress at the state level. Local governments can expect state aid to shield them from fiscal stress only if the state itself is fiscally healthy.

4/ A larger than average dependence of local governments on the property tax makes them more vulnerable to sagging agricultural land values (at least in the long run, as property assessments gradually reflect the decline).

5/ On a scale of 1 to 5, 1 is greatest freedom from state control and 5 is least. The less freedom that local governments have from state control concerning their fiscal affairs, the less likely the local governments are to be able to cope with their own fiscal stresses. An index of 4.0 or greater indicates potential difficulty.

Source: ACIR Staff Compilation based on ACIR, *Significant Features of Fiscal Federalism*, 1985-86, various tables, and on ACIR, *Measuring Local Discretionary Authority*, report M-131, November 1981, various tables.

in five states are exhibiting signs of fiscal stress: North Dakota, Iowa, Nebraska, Missouri and Montana.

### Indicators for Farm-Dependent Local Governments

*Table 3* compares the sources of revenue available to local governments in the farm-dependent counties vis-a-vis local governments in all other counties in the ten sample states.* Unlike *Tables 1 and 2*, information contained in this table does not provide direct indicators of fiscal condition. It does, however, indicate exposure of agriculturally-dependent governments to reductions in state and federal aid. *Table 3* also gives an indication of the reliance of these governments on the property tax and other local own-source revenue.

The first observation about *Table 3* is that agriculturally-dependent local governments tend to rely more heavily on federal general revenue sharing (GRS) than other governments (column 3). As a result, the termination of GRS this year would hurt agriculturally-dependent governments more than other jurisdictions. Furthermore, because GRS funds were available to general purpose governments only, the impact of the discontinuation of this program likely will have a greater effect on these localities than the figures in *Table 3* would suggest, since data for school and special districts are included in these figures.

Secondly, in eight of the ten states surveyed, agriculturally-dependent local governments are relying more heavily on state aid than other governments (column 5). Thus, cuts in state aid would be more likely to hurt governments in agriculturally-dependent areas than in other areas. Agriculturally-dependent local governments in North Dakota, Arkansas, Minnesota and Mississippi receive from 44-60% of their general revenue from their respective state governments. All of these state governments are exhibiting signs of fiscal stress.

*These data represent county level aggregates for *all types of governments* within each county—i.e., county, city and township governments, as well as school districts and special districts.

Finally, agriculturally-dependent local governments in six of the ten states examined rely more heavily on the property tax than do other governments. This, however, is an ambiguous indicator. Although we know that there have been substantial decreases in the value of farm land, we cannot assume a significant decline in property tax revenue in the short run. Property tax revenues tend to be fairly stable for three reasons. First, the drop in *assessed* values of farm land usually occurs with a significant time lag after the actual drop in the price of farm land. Second, in the absence of tax rate limitations, reduced assessments reflecting market conditions can trigger increased mill rates designed to maintain needed revenues. Finally, when land is assessed on the basis of use value rather than on market value, the fluctuations in use value tend to be considerably less than the fluctuations in market value.

Because the property tax is considered by public finance experts to be one of the most stable sources of revenue, a high degree of dependence on this tax source tends to act as an "insurance policy" for local governments against economic downturns. Despite the increased property tax burden placed on financially-strained taxpayers, the stability of the property tax tends to protect local governments from the vagaries of local economic conditions in the short-term.

In all likelihood, the farm-dependent counties eventually will experience a downturn in their most important revenue source—the property tax. Thus, they will be faced with the need to cut expenditures and service levels, seek additional revenues, or both.

## Conclusion

The ACIR reconnaissance study of ten sample states reveals these major findings:

- Local governments in North Dakota and Montana show signs of fiscal stress, and the state govern-

**Table 3**
**Local Government Revenues in Farm-Dependent vs. All Counties in Ten Sample States, 1982**

| | (1) Percentage of All Counties Ag-Dependent | (2) Total General Revenue | (3) Federal General Revenue Sharing | (4) All Other Federal Aid | (5) State Aid | (6) Property Taxes | (7) Other Taxes Charges & Misc. Gen. Rev. |
|---|---|---|---|---|---|---|---|
| U.S. PCT. DIST ALL LOCAL | n.a. | 100.0% | 1.6% | 5.9% | 33.9% | 28.1% | 30.4% |
| North Dakota: Non-Ag. | | 100.0 | 1.5 | 5.6 | 39.2 | 26.2 | 27.6 |
| North Dakota: Ag. | 71.7 | 100.0 | 2.2 | 3.4 | 46.0 | 28.1 | 20.4 |
| Iowa: Non-Ag. | | 100.0 | 1.5 | 4.3 | 33.4 | 36.1 | 24.7 |
| Iowa: Ag. | 52.5 | 100.0 | 1.9 | 2.2 | 34.6 | 38.3 | 23.1 |
| Nebraska: Non-Ag. | | 100.0 | 1.5 | 5.2 | 19.6 | 35.4 | 38.3 |
| Nebraska: Ag. | 69.9 | 100.0 | 2.3 | 2.3 | 22.6 | 45.7 | 27.1 |
| Arkansas: Non-Ag. | | 100.0 | 2.5 | 5.9 | 35.5 | 21.9 | 34.2 |
| Arkansas: Ag. | 37.3 | 100.0 | 2.8 | 6.8 | 47.3 | 16.8 | 26.2 |
| Kansas: Non-Ag. | | 100.0 | 1.5 | 4.6 | 24.3 | 33.5 | 36.0 |
| Kansas: Ag. | 38.1 | 100.0 | 1.7 | 1.7 | 17.5 | 49.8 | 29.3 |
| Georgia: Non-Ag. | | 100.0 | 1.8 | 6.6 | 25.4 | 23.7 | 42.5 |
| Georgia: Ag. | 20.1 | 100.0 | 3.4 | 2.9 | 43.6 | 22.7 | 27.5 |
| Minnesota: Non-Ag. | | 100.0 | 1.5 | 5.1 | 44.6 | 22.4 | 26.4 |
| Minnesota: Ag. | 40.2 | 100.0 | 1.9 | 2.6 | 44.8 | 22.3 | 28.4 |
| Mississippi: Non-Ag. | | 100.0 | 2.5 | 5.2 | 39.0 | 17.4 | 35.9 |
| Mississippi: Ag. | 23.2 | 100.0 | 4.1 | 2.0 | 59.6 | 14.5 | 19.8 |
| Missouri: Non-Ag. | | 100.0 | 1.8 | 7.9 | 24.8 | 25.4 | 40.2 |
| Missouri: Ag. | 31.3 | 100.0 | 2.2 | 4.6 | 30.2 | 26.9 | 36.0 |
| Montana: Non-Ag. | | 100.0 | 1.8 | 5.6 | 25.2 | 44.1 | 23.3 |
| Montana: Ag. | 42.9 | 100.0 | 2.0 | 3.9 | 17.3 | 54.4 | 22.5 |

Source: List of counties that have 20% or more of all personal income directly from farming obtained from Economic Research Division of the U.S. Department of Agriculture; government finance data from U.S. Bureau of the Census, *1982 Census of Governments, Compendium of Government Finance,* Vol. 4, No. 5, Table 50. ACIR staff compilation and computations.

ments are facing financial strains which may limit their ability to help shield localities from the combined effects of the farm recession and the decline in energy prices.

- Local governments in Iowa and Nebraska also show signs of fiscal stress; in addition, these state governments are experiencing some degree of financial stress. State help in dealing with local fiscal problems stemming from the farm crisis is more likely here than in North Dakota and Montana, but the states will not find it easy.
- Local governments in Missouri show signs of fiscal stress, but the state does not. Thus, the state may be in a better position to help shield its local governments from the farm recession.
- Localities in Arkansas, Kansas, Minnesota and Mississippi show few signs of increasing fiscal stress, although the state governments in these four cases do appear to be financially strained. If further local stress should develop, state help might be problematic.
- Local governments in Georgia appear to be relatively trouble free fiscally, as does the state government.
- Local governments in the heavily farm-dependent counties of the ten sample states will be hurt more than nonfarm counties by the termination of federal general revenue sharing. These localities—as is typical of smaller governments—receive a larger proportion of federal grants in the form of general revenue sharing than do their nonfarm counterparts.
- Most of the farm counties are more dependent on state aid than are their nonfarm counterparts.
- Because of the inherent "stickiness" of property tax assessment levels, most farm counties in the sample have yet to register substantial drops in property tax revenue. However, over time, the significant deterioration in the property tax base will be reflected in diminished property tax collections.
- In striking contrast to the relative stability of local property tax revenues, major state revenue sources—especially general sales and income taxes exhibit a high degree of sensitivity to the changes in the state economy. The vulnerability of state revenue systems to the decline in the farm economy is strikingly illustrated by the recent sharp drop in revenue flows in Nebraska, North Dakota and Montana.
- Since state revenue systems are highly sensitive to economic fluctuations, the most immediate threat posed by the farm crisis for local governments will come in the form of reductions in state aid. Reductions in aid to local school systems already have occurred in several states—Iowa, Nebraska, Arkansas and Montana.

*Michael Lawson is an ACIR Analyst. This article is based on an ACIR staff information report "The Agricultural Recession: Its Impact on the Finances of State and Local Governments" prepared by Lawson, Susannah Calkins, and Bruce McDowell.*

A Fiscal Note

# 1984 State Tax Wealth: Preview of the RTS Estimates

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**Analyst**

State tax experts, economic development specialists, policymakers and others will be interested in ACIR's latest estimates of fiscal capacity and effort. The 1984 results, just completed, continue to highlight the changes occurring in the relative economic and fiscal health and policies of the states. Particularly apparent with the 1984 figures are regional trends in tax capacity or wealth—the ability of the states and their local governments to raise revenues from the tax sources available to them.

Using the Representative Tax System (RTS) methodology, ACIR's preliminary estimates of state-local fiscal capacity and tax effort for 1984 are shown in *Table 1* and mapped in *Figure 1*. Both tax capacity and tax effort are indexed to a U.S. average of 100. For example, New Hampshire—with a capacity index of 110—has capacity 10% above the national average, while Vermont—with an index of 95—has capacity 5% below average.

### 1984 Tax Capacity

Tax capacity, as estimated under the RTS, is a hypothetical measure of how much revenue a state could raise if it levied national average tax rates and used tax bases "representative" of most other states. It is calculated by applying national average tax rates in each state to a uniform set of 26 state and local tax bases, and estimating the yield based on the size of the underlying tax bases. Because the size of a state's tax bases is directly affected by the condition of its economy, the capacity measure reflects both the state of the economy and how that translates into the potential revenue-raising ability of each state.

*Table 1* shows the range of state-local capacities in 1984 relative to the average, as well as some fairly pronounced regional patterns. The three states with the highest ca-

**Figure 1**
**Classification of States According to Tax Wealth Based on the 1984 RTS Capacity Estimates**

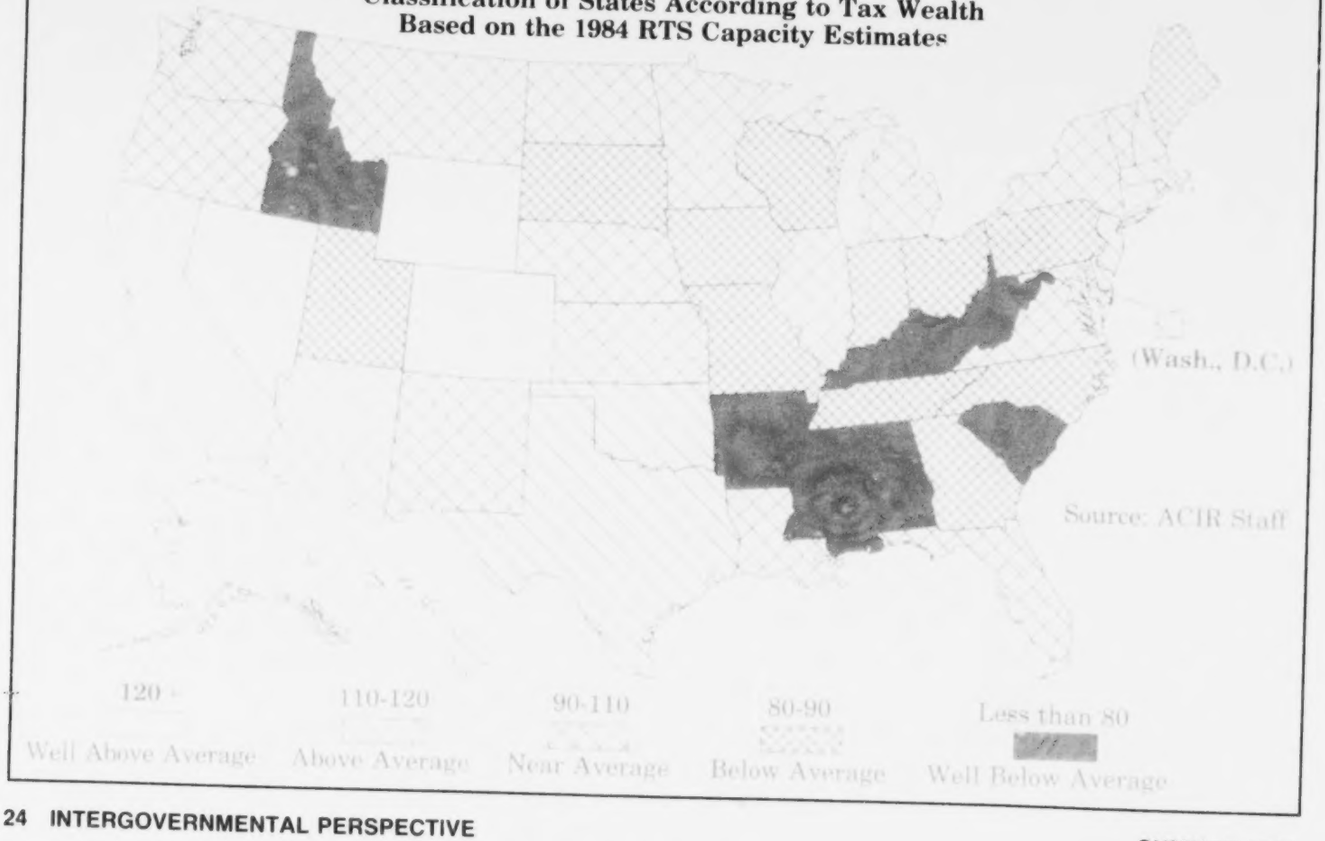

**Table 1**

**Preliminary 1984 RTS Tax Capacity and Tax Effort Indices**

| State | 1984 Capacity | 1984 Effort |
|---|---|---|
| U.S. Average | 100 | 100 |
| New England | | |
| Connecticut | 124 | 99 |
| Maine | 88 | 105 |
| Massachusetts | 111 | 105 |
| New Hampshire | 116 | 69 |
| Rhode Island | 86 | 120 |
| Vermont | 95 | 94 |
| Mideast | | |
| Delaware | 128 | 77 |
| Dist. of Columbia | 120 | 139 |
| Maryland | 105 | 100 |
| New Jersey | 118 | 109 |
| New York | 99 | 158 |
| Pennsylvania | 88 | 105 |
| Great Lakes | | |
| Illinois | 97 | 110 |
| Indiana | 87 | 95 |
| Michigan | 93 | 120 |
| Ohio | 90 | 105 |
| Wisconsin | 99 | 120 |
| Plains | | |
| Iowa | 87 | 113 |
| Kansas | 100 | 95 |
| Minnesota | 101 | 124 |
| Missouri | 90 | 85 |
| Nebraska | 93 | 99 |
| North Dakota | 105 | 93 |
| South Dakota | 89 | 87 |
| Southeast | | |
| Alabama | 73 | 90 |
| Arkansas | 75 | 87 |
| Florida | 105 | 74 |
| Georgia | 89 | 89 |
| Kentucky | 77 | 89 |
| Louisiana | 102 | 81 |
| Mississippi | 70 | 95 |
| North Carolina | 87 | 89 |
| South Carolina | 77 | 95 |
| Tennessee | 81 | 81 |
| Virginia | 96 | 86 |
| West Virginia | 79 | 100 |
| Southwest | | |
| Arizona | 99 | 96 |
| New Mexico | 103 | 85 |
| Oklahoma | 113 | 76 |
| Texas | 117 | 69 |
| Rocky Mountain | | |
| Colorado | 121 | 82 |
| Idaho | 78 | 91 |
| Montana | 95 | 101 |
| Utah | 81 | 105 |
| Wyoming | 181 | 105 |
| Far West | | |
| California | 119 | 93 |
| Nevada | 146 | 65 |
| Oregon | 94 | 103 |
| Washington | 99 | 103 |
| Alaska | 250 | 141 |
| Hawaii | 118 | 99 |

Source: ACIR Staff Estimates

pacities by far were Alaska (250), Wyoming (181), and Nevada (146), all of which have large amounts of taxable resources not generally available to other states—mineral resources in the case of Alaska and Wyoming, tourism in the case of Nevada. Most of the states in the New England and Mideast regions, as well as those in the Southwest, Far West, and Rocky Mountain regions, had average or above-average capacities. The Great Lakes and Plains states tend to have capacities near or below the average, while the region which was worst off is the Southeast, containing six of the seven states that had indices below 80.

While the regional patterns of capacity reflect similarities in economic makeup, demographics and other factors, the states that stand out as having higher capacity than those in the rest of their regions in some cases have large endowments of natural resources (e.g., North Dakota, Louisiana, Texas and Wyoming) or other unusual circumstances such as tourism (e.g., Nevada and Hawaii) which provide additional taxing opportunities. Moreover, the possibility that taxes on these unusual resources may be "exported" to residents of other states lends their presence an even greater weight in that state's total tax capacity.

### 1984 Tax Effort

*Table 1* also shows the overall tax effort index for each state. In the RTS framework, tax effort is a measure of the extent to which a state uses the tax bases available to it, relative to the national average. Calculated by comparing a state's actual tax revenues to its hypothetical tax capacity, it is a measure of tax utilization relative to capacity. Since tax capacity is based on national average tax rates and bases, a state's tax effort figure also is a measure of that state's statutory tax burden relative to the average state tax system. Tax effort is not, however, a measure of the final incidence of taxes. A state with significant tax exporting opportunities may be able to pass on a portion of its taxes to residents of other states, thereby reducing the effective tax burden on its own residents.

In 1984, New York (158), Alaska (141), and the District of Columbia (139) had the highest tax efforts. The states with the lowest efforts were Nevada (65), Texas (69), and New Hampshire (69). As with tax capacity, regional patterns also exist in the distribution of tax effort indices among the states. High tax effort states tend to be concentrated in the Great Lakes, Mideast and New England regions, while most of the states in the Southeast, Southwest and Plains regions have relatively low tax efforts.

There are many relationships of tax capacity to tax effort among the states. The New England and Mideast states generally combine high capacity with high effort and the Southeastern states below-average capacity with below-average effort, but other patterns also are possible. The Great Lakes states have average to below-average tax capacities but above-average tax efforts, while the Southwestern states with above-average capacities have relatively low tax efforts.

### Short-Term Trends in Fiscal Capacity

*Table 2* shows the states which had the largest increases and decreases in fiscal capacity between 1983 and 1984. While overall RTS index changes of a couple of points or less are probably not significant due to data imperfections and the relative nature of the indices, changes of the magnitude shown in the table clearly reflect underlying currents in the economy. In this table, the regions and industries undergoing the most dramatic changes in 1984 are highlighted.

The regions experiencing the greatest overall gains between 1983 and 1984 were the Mideast and Northeast. Five of the eight states with the largest capacity gains are in these regions, which continued to experience a rebound in fiscal capacity since the recession of the early 1980s. In 1984, the Great Lakes region also showed signs of recovery from the recession, with Michigan leading the way and making it into the group of top gainers. However, unlike the Northeast and Mideast, this was the first year of improvement for states in this region. In the other direction, all 11 of the states which experienced the largest capacity

decreases are either large energy-producing or farming states. These states continued to be hard hit by falling prices and less competitive exports.

### Long-Term Regional Trends

*Table 3* presents the historical series of RTS tax capacity indices for each state. The existence of this series, dating back to the 1960s, when the methodology was developed and published annually since 1979, permits examination of long-term trends affecting capacity. From the vantage point of 1984, the following trends are the most significant:

- Almost all of the Northeast and Mideast states continued to show improvements in their fiscal capacities, a trend that began in 1982 following the downturn in 1981. This improvement can be partly attributed to expansion in high-tech and defense-related industries, particularly for the Northeast, and has resulted in the states in these regions becoming or maintaining their positions as some of the wealthiest in the nation. The only state in these regions that has experienced a long-term decline is Pennsylvania, that went from a capacity index in the high 90s in the mid-1970s to one of 88 in 1983 and 1984.
- In 1984, the Great Lakes states showed the first small signs of a turnaround in fiscal capacity since 1980, with Michigan increasing by three percentage points, Wisconsin by two points, and Indiana and Ohio by one point. Only Illinois continued to slip, with a decrease of one percentage point. The recovery of the automobile and related industries played a large part in helping this region out of a severe fiscal decline, although it was still struggling with a depressed farm sector. For instance, Illinois' continued downward trend in 1984 was strongly influenced by that state's large industrial base in farm implements and machinery.
- The farm-dependent states in the Plains and Rocky Mountain regions continued a long-term decline beginning around 1980 that reduced the capacities in some of those states by more than ten points. Between 1979 and 1984, Iowa's capacity was reduced by 19 percentage points, South Dakota's by 12 points, and Idaho's by 13 points. Among other factors, the loss of foreign markets has been a large contributor to the weakness of the domestic farm sector.
- As oil prices declined from their peak in 1981, so did the capacities of the energy-producing states. Alaska, the quintessential energy state, declined in capacity from 324 in 1981 to 250 in 1984, a decrease of 74 points or 23%. Wyoming, that went from 216 to 181 over the same period, experienced the next largest decrease in both absolute and percentage terms (35 points and 16%). Louisiana, New Mexico, Oklahoma and Texas all underwent capacity declines of 10 to 15 percentage points. As oil prices have continued to drop in 1985—and especially 1986—the capacities of these states can be expected to fall even further.
- Influenced by both lower energy prices and reduced exports, the capacities of most of the major coal-producing states fared as badly or worse than those of the other energy states. Montana's capacity fell by 19 points (114 to 95) between 1981 and 1984, and North Dakota's by 17 points (123 to 106). West Virginia's score went from 94 in 1980 to 79 in 1984, plunging it back into the 70s for the first time since the late 1960s. Kentucky experienced the smallest decline in capacity—decreasing five points since 1982—but with a 1984 index of 77, was fifth from the bottom in capacity among all the states.
- Fiscal capacity doldrums continued in the Southeastern region, especially in Alabama, Arkansas, Mississippi and South Carolina. While these states have increased their taxing capacity in absolute terms at average or above-average rates since the late 1960s, over the length of the historical series they have remained among the poorest in relative tax capacity. Georgia, North Carolina and Virginia, however, appear to have achieved modest—but lasting—gains in capacity since the mid-1970s.

**Table 2**

**Largest Gainers and Losers in RTS Tax Capacity Between 1983 and 1984 (in index points)**

| Gainers | | Losers | |
|---|---|---|---|
| Maryland | +6 | Alaska | −22 |
| Delaware | +5 | Montana | −10 |
| Hawaii | +4 | Nebraska | − 8 |
| Massachusetts | +4 | West Virginia | − 8 |
| Minnesota | +4 | Texas | − 7 |
| District of Columbia | +3 | Idaho | − 5 |
| New York | +3 | Louisiana | − 5 |
| Michigan | +3 | New Mexico | − 5 |
| | | North Dakota | − 5 |
| | | Iowa | − 4 |
| | | South Dakota | − 4 |

Source: ACIR Staff Estimates

### Additional Fiscal Capacity Information To Be Released

A full ACIR report containing the 1984 RTS results and a discussion of the RTS methodology will be forthcoming. That report will present the set of tables disaggregating the RTS into its 26 component tax bases. It also will contain graphs for each state that describe tax mix and utilization, and trace overall trends in capacity and effort. The detailed data to be presented in the report are par-

**Table 3**
**RTS TAX CAPACITY INDICES FOR 1984 AND SELECTED PRIOR YEARS**

| State | 1984 | 1983 | 1982 | 1981 | 1980 | 1979 | 1977 | 1975 | 1967 |
|---|---|---|---|---|---|---|---|---|---|
| U.S. Average | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| New England | | | | | | | | | |
| Connecticut | 124 | 124 | 117 | 110 | 112 | 109 | 112 | 110 | 117 |
| Maine | 88 | 90 | 84 | 79 | 80 | 80 | 82 | 84 | 81 |
| Massachusetts | 111 | 107 | 101 | 96 | 96 | 93 | 95 | 98 | 98 |
| New Hampshire | 110 | 108 | 100 | 95 | 97 | 96 | 102 | 102 | 110 |
| Rhode Island | 86 | 86 | 81 | 80 | 84 | 84 | 87 | 88 | 91 |
| Vermont | 95 | 94 | 89 | 84 | 84 | 85 | 93 | 94 | 88 |
| Mideast | | | | | | | | | |
| Delaware | 123 | 118 | 115 | 111 | 111 | 110 | 120 | 124 | 123 |
| Dist. of Col. | 120 | 117 | 115 | 111 | 111 | 110 | 123 | 118 | 121 |
| Maryland | 105 | 99 | 100 | 98 | 99 | 99 | 101 | 101 | 101 |
| New Jersey | 114 | 112 | 106 | 105 | 105 | 102 | 106 | 109 | 107 |
| New York | 98 | 95 | 92 | 89 | 90 | 89 | 94 | 98 | 108 |
| Pennsylvania | 88 | 88 | 89 | 90 | 93 | 93 | 99 | 98 | 91 |
| Great Lakes | | | | | | | | | |
| Illinois | 97 | 98 | 99 | 104 | 108 | 112 | 112 | 112 | 114 |
| Indiana | 87 | 86 | 89 | 91 | 92 | 98 | 100 | 98 | 99 |
| Michigan | 93 | 90 | 93 | 96 | 97 | 104 | 103 | 101 | 104 |
| Ohio | 90 | 89 | 92 | 94 | 97 | 101 | 104 | 104 | 100 |
| Wisconsin | 89 | 87 | 87 | 91 | 95 | 100 | 99 | 98 | 94 |
| Plains | | | | | | | | | |
| Iowa | 87 | 91 | 96 | 102 | 105 | 108 | 105 | 106 | 104 |
| Kansas | 100 | 102 | 106 | 109 | 109 | 109 | 105 | 109 | 105 |
| Minnesota | 101 | 97 | 99 | 100 | 102 | 105 | 100 | 97 | 95 |
| Missouri | 89 | 89 | 91 | 92 | 94 | 97 | 96 | 96 | 97 |
| Nebraska | 93 | 101 | 97 | 97 | 97 | 100 | 101 | 106 | 110 |
| North Dakota | 106 | 111 | 115 | 123 | 108 | 109 | 99 | 101 | 92 |
| South Dakota | 83 | 87 | 87 | 86 | 90 | 95 | 91 | 94 | 91 |
| Southeast | | | | | | | | | |
| Alabama | 73 | 75 | 74 | 74 | 76 | 76 | 77 | 77 | 70 |
| Arkansas | 75 | 78 | 79 | 82 | 79 | 77 | 78 | 78 | 77 |
| Florida | 105 | 103 | 104 | 101 | 100 | 100 | 101 | 102 | 104 |
| Georgia | 89 | 87 | 84 | 81 | 82 | 81 | 84 | 86 | 80 |
| Kentucky | 77 | 79 | 82 | 82 | 83 | 85 | 83 | 85 | 80 |
| Louisiana | 102 | 107 | 113 | 117 | 109 | 104 | 99 | 97 | 94 |
| Mississippi | 70 | 68 | 71 | 72 | 69 | 70 | 70 | 70 | 64 |
| North Carolina | 87 | 87 | 82 | 80 | 80 | 82 | 83 | 85 | 78 |
| South Carolina | 77 | 76 | 74 | 75 | 75 | 76 | 77 | 77 | 64 |
| Tennessee | 81 | 80 | 77 | 79 | 79 | 81 | 83 | 84 | 78 |
| Virginia | 96 | 96 | 94 | 94 | 95 | 93 | 91 | 93 | 86 |
| West Virginia | 79 | 87 | 92 | 90 | 94 | 92 | 90 | 89 | 75 |
| Southwest | | | | | | | | | |
| Arizona | 99 | 97 | 96 | 89 | 89 | 91 | 89 | 92 | 95 |
| New Mexico | 103 | 108 | 115 | 114 | 107 | 103 | 98 | 97 | 94 |
| Oklahoma | 113 | 115 | 126 | 127 | 117 | 108 | 101 | 98 | 102 |
| Texas | 117 | 124 | 130 | 132 | 124 | 117 | 112 | 111 | 98 |
| Rocky Mountain | | | | | | | | | |
| Colorado | 121 | 122 | 121 | 113 | 113 | 110 | 107 | 106 | 104 |
| Idaho | 78 | 83 | 86 | 87 | 87 | 91 | 88 | 89 | 91 |
| Montana | 95 | 105 | 110 | 114 | 112 | 113 | 103 | 103 | 105 |
| Utah | 81 | 82 | 86 | 86 | 86 | 87 | 88 | 86 | 87 |
| Wyoming | 181 | 182 | 201 | 216 | 196 | 173 | 154 | 154 | 141 |
| Far West | | | | | | | | | |
| California | 119 | 119 | 116 | 115 | 117 | 116 | 114 | 110 | 124 |
| Nevada | 146 | 147 | 151 | 148 | 154 | 154 | 148 | 145 | 171 |
| Oregon | 94 | 96 | 99 | 99 | 103 | 106 | 104 | 100 | 106 |
| Washington | 99 | 101 | 102 | 99 | 103 | 103 | 100 | 98 | 112 |
| Alaska | 250 | 272 | 313 | 324 | 260 | 217 | 158 | 155 | 99 |
| Hawaii | 118 | 114 | 117 | 105 | 107 | 103 | 107 | 109 | 99 |

Source: ACIR preliminary staff estimates for 1984. Other years may be obtained from ACIR, *1983 Tax Capacity of the States*, M-148, Washington, D.C.

ticularly useful for state tax policy analysis.

Since the RTS was developed, there have been numerous refinements to its methodology. One of the most important of these modifications has been the development of a more comprehensive capacity measure, called the Representative Revenue System or RRS, based on the RTS but incorporating more revenue sources. In addition to the 26 regular RTS bases, the RRS includes all other taxes, user fees and charges, and mineral rents and royalties. Since the complete RTS is a component of the RRS, it will continue to be published as a consistent series. The RRS simply represents another measure of fiscal capacity that includes non-tax revenue sources. The 1984 index results of the RTS, an intermediate measure based on all taxes, and the RRS can be compared in *Table 4* and will be discussed at more length in the full report.

As part of ACIR's ongoing effort to contribute to the improvement of the measurement of fiscal capacity, the report presenting the 1984 estimates will go beyond discussing only the RTS and RRS results and methodologies. For the first time, it also will present a comparative analysis of several different fiscal capacity measures, including per capita income, export-adjusted income, gross state product, total taxable resources, the RTS, and the RRS. The report will describe the various measures, emphasizing the different concepts underlying each and the uses for which each is most appropriate. It will be published later this year.

**TABLE 4**
**COMPARISON OF RTS-BASED CAPACITY INDICES FOR 1984**

| STATE | Standard RTS Tax Capacity Index | RTS-Based All-Tax Capacity Index | RRS Fiscal Capacity Index |
|---|---|---|---|
| Alabama | 73.2 | 78.3 | 78.2 |
| Alaska | 249.8 | 245.5 | 356.7 |
| Arizona | 98.7 | 98.5 | 96.1 |
| Arkansas | 75.0 | 75.0 | 74.1 |
| California | 119.3 | 119.1 | 117.5 |
| Colorado | 121.3 | 120.8 | 118.9 |
| Connecticut | 124.3 | 124.5 | 125.8 |
| Delaware | 122.5 | 121.9 | 126.6 |
| District of Columbia | 119.8 | 120.3 | 120.5 |
| Florida | 104.6 | 104.4 | 101.8 |
| Georgia | 89.3 | 89.3 | 88.0 |
| Hawaii | 117.8 | 117.2 | 113.1 |
| Idaho | 77.9 | 78.0 | 77.3 |
| Illinois | 96.6 | 97.0 | 97.9 |
| Indiana | 87.4 | 87.5 | 86.7 |
| Iowa | 86.5 | 86.9 | 87.0 |
| Kansas | 100.2 | 100.4 | 99.3 |
| Kentucky | 77.1 | 77.2 | 76.5 |
| Louisiana | 102.3 | 101.6 | 106.5 |
| Maine | 88.0 | 87.9 | 86.2 |
| Maryland | 105.4 | 105.7 | 105.2 |
| Massachusetts | 111.0 | 111.2 | 110.4 |
| Michigan | 92.7 | 92.9 | 93.2 |
| Minnesota | 101.2 | 101.3 | 100.0 |
| Mississippi | 69.6 | 69.5 | 68.5 |
| Missouri | 89.3 | 89.5 | 90.1 |
| Montana | 95.2 | 94.8 | 95.7 |
| Nebraska | 93.1 | 93.3 | 93.0 |
| Nevada | 145.6 | 144.0 | 136.1 |
| New Hampshire | 110.2 | 110.0 | 110.9 |
| New Jersey | 114.1 | 114.3 | 118.2 |
| New Mexico | 103.4 | 102.5 | 121.3 |
| New York | 98.4 | 98.9 | 100.3 |
| North Carolina | 86.6 | 86.5 | 85.1 |
| North Dakota | 105.8 | 105.5 | 106.3 |
| Ohio | 89.9 | 90.1 | 91.3 |
| Oklahoma | 113.0 | 112.2 | 108.2 |
| Oregon | 93.6 | 93.5 | 92.1 |
| Pennsylvania | 88.3 | 88.6 | 88.6 |
| Rhode Island | 86.3 | 86.8 | 90.5 |
| South Carolina | 76.5 | 76.6 | 75.7 |
| South Dakota | 83.1 | 83.2 | 82.8 |
| Tennessee | 80.5 | 80.5 | 79.3 |
| Texas | 117.4 | 116.7 | 113.5 |
| Utah | 80.5 | 80.3 | 80.8 |
| Vermont | 95.4 | 94.9 | 91.7 |
| Virginia | 95.8 | 96.1 | 95.8 |
| Washington | 99.1 | 99.2 | 97.7 |
| West Virginia | 79.3 | 79.2 | 77.3 |
| Wisconsin | 88.7 | 89.1 | 89.0 |
| Wyoming | 181.4 | 178.1 | 201.5 |
| U.S. TOTAL | 100.0 | 100.0 | 100.0 |

Source: ACIR Staff Estimates

# And Briefly: Books

**Kelly McManus**
**Information Officer**

**SPECIAL NOTE**
**An errata sheet has been prepared for the 1985-86 edition of *Significant Features of Fiscal Federalism* (M-146). The sheet replaces Table 114 on page 190: "STATE RANKINGS FOR SELECTED EXPENDITURE ITEMS, PER CAPITA AND AS A PERCENTAGE OF STATE PERSONAL INCOME, FY84 (State and Local Government Expenditure)". A copy of the replacement page has been reproduced in this issue of *Intergovernmental Perspective* for your convenience.**

**The following publications may be ordered directly from ACIR.**

### The Agricultural Recession: Its Impact on the Finances of State and Local Governments (June 1986), $5.00

This staff information report was completed in response to a request from Senator David Durenberger (MN) to assist the Senate Subcommittee on Intergovernmental Relations in its study of the effects of the farm crisis on state and local governments. The report is featured in the "Special Report" section of this issue of *Intergovernmental Perspective.*

### The Transformation in American Politics: Implications for Federalism (A-106), $10.00

This Commission report examines the transformation of political party structures and analyzes their effects on intergovernmental relations. Of special interest are sections tracing the evolution and influence of national, state and local party organizations; the role of the media; campaign finance and the growth of political action committees; and the influence of special interest groups on party policies and procedures.

Recommendations address five policy areas: enacting new and modifying existing state laws affecting political parties' roles in nominations and elections; reforming state regulation of party organizational structures, composition and procedures; changing the status of state and local parties under the *Federal Election Campaign Act;* assuring political party access to the media; and the role of cable television in community affairs.

**Other Recent ACIR Reports:**

**Reflections on *Garcia* and Its Implications for Federalism (M-147), $3.00**

**A Framework for Studying the Controversy Concerning the Federal Courts and Federalism (M-149), $3.00**

**Devolving Federal Program Responsibilities and Revenue Sources to State and Local Governments (A-104), $3.00**

**Significant Features of Fiscal Federalism, 1985-86 Edition (M-146), $10.00**

**Forthcoming:**

**Changing Public Attitudes on Governments and Taxes, 1986**

**Tort Reform and Liability Insurance: Proceedings from the Joint National/State ACIR Conference**

**The following publications may be ordered directly from the publishers cited.**

**Financing State and Local Governments,** by J. Richard Aaronson and John Hilley, 4th edition, The Brookings Institution, 1775 Massachusetts Avenue, N.W., Washington, D.C. 20036, $9.95

**The Economic and Budget Outlook: An Update,** Congressional Budget Office, Washington, D.C. 20515 (August 1986)

**City Fiscal Conditions in 1986,** National League of Cities, 1301 Pennsylvania Avenue, N.W., Washington, D.C. 20004, $15.00/$10.00 NLC members (July 1986)

**Fiscal Survey of the States,** National Governors' Association and National Association of State Budget Officers, 444 North Capitol Street, Washington, D.C. 20001, $20.00 (August 1986)

**State Budget Actions in 1986,** National Conference of State Legislatures, 1050 Seventeenth Street, Suite 2100, Denver, Colorado 80265, $25.00 (September 1986)

**The Book of States, 1986-87 Edition,** The Council of State Governments, P.O. Box 11910, Lexington, Kentucky 40578, $42.50

**The Municipal Yearbook 1986,** International City Management Association, 1120 G Street, N.W., Washington, D.C. 20005, $60.00

ERRATA: TO REPLACE TABLE 114, PAGE 190 OF SIGNIFICANT FEATURES OF FISCAL FEDERALISM, 1985-86 EDITION

TABLE 114--STATE RANKINGS FOR SELECTED EXPENDITURE ITEMS, PER CAPITA AND AS A PERCENTAGE OF STATE PERSONAL INCOME, FY84
(STATE AND LOCAL GOVERNMENT EXPENDITURE)

| State-Local Direct Education Expenditure | | | | | State-Local Direct Elementary & Secondary Education Expenditure | | | | State-Local Direct Higher Education Expenditure | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Rank | State | Per Capita | State | As a % of Personal Income | State | Per Capita | State | As a % of Personal Income | State | Per Capita | State | As a % of Personal Income | Rank |
| 1 | AK | $2,309 | AK | 14.0% | AK | $1,673 | AK | 10.2% | AK | $569 | AK | 3.5% | 1 |
| 2 | WY | 1,526 | WY | 12.7 | WY | 1,104 | WY | 9.2 | WY | 390 | UT | 3.3 | 2 |
| 3 | DE | 952 | NM | 9.9 | NY | 670 | MT | 6.8 | DE | 335 | WY | 3.3 | 3 |
| 4 | NM | 939 | UT | 9.8 | MT | 667 | NM | 6.6 | ND | 330 | NM | 3.0 | 4 |
| 5 | ND | 929 | MT | 9.3 | NM | 627 | UT | 6.1 | WI | 299 | ND | 2.9 | 5 |
| 6 | MT | 916 | VT | 8.5 | OR | 625 | OR | 5.8 | UT | 292 | VT | 2.8 | 6 |
| 7 | WI | 903 | OR | 8.4 | DC | 619 | WV | 5.4 | IA | 290 | AZ | 2.7 | 7 |
| 8 | OR | 902 | ND | 8.0 | MN | 608 | NY | 5.2 | NM | 288 | IA | 2.7 | 8 |
| 9 | MN | 893 | WI | 8.0 | NJ | 608 | MI | 5.2 | AZ | 282 | DE | 2.7 | 9 |
| 10 | NY | 885 | IA | 7.9 | MI | 592 | VT | 5.1 | VT | 276 | WI | 2.6 | 10 |
| 11 | UT | 865 | AZ | 7.8 | WI | 573 | MN | 5.1 | HI | 271 | MS | 2.5 | 11 |
| 12 | MI | 857 | DE | 7.6 | CO | 566 | SD | 5.1 | KS | 264 | AL | 2.4 | 12 |
| 13 | IA | 844 | WV | 7.6 | ND | 559 | WI | 5.1 | OR | 256 | OR | 2.4 | 13 |
| 14 | VT | 843 | MN | 7.5 | NE | 552 | NE | 5.0 | CO | 255 | NC | 2.4 | 14 |
| 15 | CO | 841 | MI | 7.5 | WA | 550 | IA | 4.9 | WA | 252 | HI | 2.3 | 15 |
| 16 | WA | 836 | MS | 7.4 | DE | 549 | ND | 4.8 | MN | 245 | ID | 2.2 | 16 |
| 17 | KS | 815 | NE | 7.3 | TX | 549 | TX | 4.8 | CA | 245 | KS | 2.2 | 17 |
| 18 | NE | 814 | SD | 7.2 | UT | 541 | ME | 4.8 | MI | 240 | SC | 2.2 | 18 |
| 19 | MD | 811 | AL | 7.1 | KS | 534 | AZ | 4.8 | NE | 238 | NE | 2.1 | 19 |
| 20 | AZ | 803 | NC | 7.1 | MD | 534 | OK | 4.7 | TX | 235 | LA | 2.1 | 20 |
| 21 | TX | 797 | SC | 7.1 | IA | 522 | OH | 4.6 | NC | 229 | MI | 2.1 | 21 |
| 22 | NJ | 777 | LA | 7.0 | OK | 517 | WA | 4.6 | AL | 223 | WA | 2.1 | 22 |
| 23 | OK | 767 | OK | 7.0 | CT | 517 | SC | 4.5 | OK | 220 | MN | 2.1 | 23 |
| 24 | CA | 759 | WA | 6.9 | OH | 513 | AR | 4.5 | MD | 217 | MT | 2.1 | 24 |
| 25 | RI | 749 | TX | 6.9 | VT | 508 | MS | 4.5 | LA | 214 | TX | 2.0 | 25 |
| 26 | DC | 743 | ME | 6.9 | MA | 497 | CO | 4.5 | ID | 211 | CO | 2.0 | 26 |
| 27 | VA | 733 | NY | 6.8 | SD | 495 | LA | 4.5 | IN | 210 | IN | 2.0 | 27 |
| 28 | LA | 715 | IN | 6.8 | WV | 494 | IN | 4.4 | VA | 208 | OK | 2.0 | 28 |
| 29 | OH | 714 | ID | 6.7 | AZ | 493 | DE | 4.4 | MT | 203 | KY | 2.0 | 29 |
| 30 | IN | 706 | KS | 6.7 | VA | 493 | KS | 4.4 | MS | 199 | SD | 1.9 | 30 |
| 31 | SD | 703 | CO | 6.7 | CA | 492 | NC | 4.4 | SC | 196 | CA | 1.9 | 31 |
| 32 | WV | 698 | AR | 6.7 | RI | 488 | NJ | 4.3 | KY | 187 | WV | 1.8 | 32 |
| 33 | CT | 685 | KY | 6.5 | PA | 475 | ID | 4.3 | RI | 186 | VA | 1.7 | 33 |
| 34 | IL | 682 | RI | 6.5 | IL | 473 | RI | 4.2 | SD | 185 | ME | 1.7 | 34 |
| 35 | NC | 682 | OH | 6.4 | ME | 466 | MD | 4.1 | OH | 185 | MD | 1.7 | 35 |
| 36 | HI | 681 | MD | 6.3 | IN | 461 | PA | 4.1 | IL | 178 | GA | 1.7 | 36 |
| 37 | ME | 670 | VA | 6.1 | LA | 456 | VA | 4.1 | GA | 172 | AR | 1.7 | 37 |
| 38 | AL | 651 | GA | 6.0 | FL | 444 | GA | 4.1 | ME | 168 | TN | 1.7 | 38 |
| 39 | MA | 646 | CA | 5.8 | NV | 440 | AL | 4.0 | NY | 166 | OH | 1.6 | 39 |
| 40 | SC | 641 | HI | 5.7 | MO | 435 | MO | 4.0 | WV | 166 | RI | 1.6 | 40 |
| 41 | ID | 636 | TN | 5.7 | NH | 431 | KY | 4.0 | TN | 157 | IL | 1.4 | 41 |
| 42 | PA | 632 | NJ | 5.5 | NC | 421 | FL | 3.9 | NV | 152 | MO | 1.4 | 42 |
| 43 | FL | 617 | MO | 5.5 | GA | 413 | DC | 3.9 | MO | 148 | NY | 1.3 | 43 |
| 44 | GA | 613 | PA | 5.5 | SC | 412 | IL | 3.8 | NH | 148 | NH | 1.3 | 44 |
| 45 | NV | 610 | IL | 5.5 | ID | 404 | CA | 3.8 | AR | 147 | NV | 1.2 | 45 |
| 46 | KY | 609 | FL | 5.5 | AR | 400 | MA | 3.8 | NJ | 146 | FL | 1.2 | 46 |
| 47 | MO | 602 | NH | 5.1 | HI | 400 | NH | 3.7 | FL | 140 | NJ | 1.0 | 47 |
| 48 | NH | 597 | NV | 5.0 | KY | 372 | TN | 3.6 | CT | 130 | PA | 0.9 | 48 |
| 49 | MS | 593 | MA | 4.9 | AL | 368 | NV | 3.6 | DC | 124 | CT | 0.9 | 49 |
| 50 | AR | 592 | DC | 4.7 | MS | 362 | CT | 3.5 | MA | 111 | MA | 0.8 | 50 |
| 51 | TN | 540 | CT | 4.6 | TN | 343 | HI | 3.4 | PA | 101 | DC | 0.8 | 51 |
| | US | $746 | US | 6.4% | US | $512 | US | 4.4% | US | $202 | US | 1.7% | |

Source: Computed on ACIR Government Finance Spreadsheet Diskettes for FY 84. These diskettes contain data supplied via magnetic tape by the U.S. Bureau of the Census.

## In the Next Issue . . .

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